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IN THE

# Supreme Court of the United States

**OCTOBER TERM, 1965**

No. 132

MARGARET L. HOLT and KATHLEEN L. MCMAHON, individually and on behalf of all other shareholders of ALLEGHANY CORPORATION similarly situated,

*Petitioners,*

*against*

ALLAN P. KIRBY, CHARLES T. IRELAND, JR., FRED M. KIRBY and ALLEGHANY CORPORATION,

*Respondents.*

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

## BRIEF OF RESPONDENT ALLAN P. KIRBY

The first words of petitioners' brief are: "This is an action to set aside a fraudulent settlement of prior stockholder derivative actions charging a violation of §14(a) of the Securities Exchange Act of 1934." The statement is incorrect. The present action* (*"Murchison"*) is one to set aside a contested judgment (the *"Zenn"* judgment),** approving a settlement of stockholder litigation as "fair, reasonable, and adequate" under the standards of New York's code for the protective regulation of stockholders' rights. It is a true collateral attack on a judg-

* *Murchison, et al.* v. *Kirby, et al.*, U. S. Dist. Ct., S.D.N.Y., 60 Civ. 3511 (R. 166).

** *Zenn, et al.* v. *Anzalone, et al.*, Sup. Ct. N. Y. Co., Index No. 7244/1954 (R. 701).

ment of the New York Supreme Court and not an equitable bill to enjoin the enforcement of a state court judgment for alleged fraud. Appeals were taken from the lower court's judgment in *Zenn* to state courts of review, but not to this Court. The presence of an issue under the Securities Exchange Act was dealt with as a minor facet of that wide-ranging stockholders' suit.*

Petitioners' first sentence is also incorrect in stating that the *Zenn* action was one charging a violation of Section 14(a) of the Securities Exchange Act of 1934,** an erroneous statement repeated through their brief. The New York court, on the contrary, found the action to be one of common law fraud (Ex. K-137, R. 1640-41),*** and not one to enforce duties or liabilities under Section 14(a).

## Statutes Involved

The statutes and rules involved, set forth in full in Appendix A, p. 1 *et seq.*, together with rules related thereto, are the following:

Securities Exchange Act §28, 48 Stat. 903 (1934), 15 U.S.C. §78bb (1963);
Fed. R. Civ. P. 52(a);
N. Y. Bus. Corp. L. §626(d) (McKinney 1963);
N.Y.C.P.L.R. 2221, 5015(a) (McKinney 1963);
N.Y.C.P.A. §§294, 296, 298, 301-02;
N.Y.R. Civ. P. 128, 130, 132;
27A Minn. Stats. Ann. Rules 26.01, 26.02, 26.04, 28.01, 29, 30.01, 31.01, 37.01, 37.02, 45.02, 45.06; 38 Minn. Stats. Ann. §597.18.

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* Ex. K-137, R. 1640-41.

** 48 Stat. 895 (1934), 15 U.S.C.A. §78n (1963) (since amended) by 78 Stat. 569, §5 (1964), 15 U.S.C.A. §78n (Supp. 1965).

*** "R" as used herein, followed by a number, refers to the page of the transcript of record.

"Ex." refers to exhibits before the District Court, which are indexed on the first pages of Vol. 1 of the Transcript of Record.

## Questions Presented

The record of this case does not raise, and cannot be stretched to reach, Questions 1 and 2 stated by petitioners* (Petition for Writ of Certiorari, p. 3).

The issue alleged and tried was whether respondent Allan P. Kirby ("Kirby") defrauded the New York court in obtaining a judgment approving his separate settlement of a contested stockholders' derivative suit (R. 174-75, 336, 344). The District Court found, after trial, that the plaintiffs had failed to prove any fraud by Kirby (R. 2325, 2327). Upon appeal, the Court of Appeals unanimously affirmed, with respect to that issue, the District Court's finding as to Kirby** (R. 2346). On this record the only question that could properly be presented by petitioners is whether these concurrent findings of fact of the courts below were "clearly erroneous" (Rule 52(a), Fed. R. Civ. P.). Petitioners present no such question and make no claim that these findings are erroneous.

The dissent in the Court of Appeals was based on the suggestion, made for the first time on appeal, that two other individuals (Robert R. Young and Robert W. Purcell) concealed or failed to proffer certain documents,

* Question 4 is dealt with in respondent Ireland's Brief. Question 5 has not been briefed in the form presented in the Petition for Certiorari, but its substance is presented in petitioners' discussion of Questions 1 and 2. It is difficult to determine whether Question 3 is argued in petitioners' brief; we conclude that it is not.

** The questions now presented by petitioners, i.e., (1) whether Kirby was obligated under §14(a) of the Securities Exchange Act of 1934 to search out and volunteer 12 documents as evidence in *Zenn*, and (2) whether the failure of the *Zenn* court to enforce such a rule justifies collateral attack against its judgment, were not raised before the District Court or the Court of Appeals.

thereby committing a fraud upon the New York Supreme Court, for which Kirby could be held responsible (R. 2351). No such claim was alleged, suggested or tried before the District Court. On the contrary, petitioners' counsel there specifically disclaimed any such wrongdoing on the part of Young and Purcell, or any claim that Kirby was jointly responsible with them (See pp. 94-96 *infra*, including a quotation from plaintiff's post-trial brief, p. 45).* Evidence which was not brought to the attention of the dissenting judge shows that Kirby, Young and Purcell did not act jointly in the settlement of the stockholders' suit (Point III, pp. 102-07, *infra*), and that there was no fraud on the part of Young and Purcell in any case. Both the District Court and the Court of Appeals found the documents allegedly "concealed" to be cumulative of evidence in *Zenn*. Again, petitioners make no claim that these findings are erroneous, and present no question on this issue.

In view of the limited issue tried below, the unanimous findings as to that issue, and the findings of cumulativeness as to the evidence claimed to support the new issue suggested for the first time on appeal, we submit that the petition for certiorari should be dismissed as improvidently granted, since it raises only a question of fact.

Each of Points I through V of our Argument (*infra*, pp. 79 to 151) independently shows reasons why petitioners' Questions 1, 2 and 5 are not reached on this record. These questions necessarily present constitutional doubts and problems of statutory interpretation concerning the respective scope of the Securities Exchange Act and the authority of the states in the field of corporation law

* The dissenting judge based his view that Kirby might be responsible for the conduct of Young or Purcell on a statement by petitioners' counsel at trial, which the dissent truncated (R. 2351). The complete statement was a disclaimer of any such charge, but the truncated portion quoted by the dissent gives the opposite impression (R. 606).

in the light of *Erie R. R.* v. *Tompkins,* 304 U. S. 64 (1938). Our argument with respect to them is found in Points VI through VIII, inclusive, of this brief (*infra,* pp. 151 *et seq.*).

## COUNTER-STATEMENT

Petitioners' "STATEMENT" is incomplete and misleading. In some instances, it contains misrepresentations* as to the facts and issues before the District Court, the Court of Appeals, and this Court. We have attempted, therefore, to provide a more adequate statement of the essential facts.

### I. The Proceedings Below.

#### (a) *The Murchison Complaint:*

On September 8, 1960, the suit from which the petitions in No. 131 and No. 132 derive was instituted in the United States District Court for the Southern District of New York by John D. Murchison and Clint W. Murchison, Jr., doing business as Murchison Brothers, of Dallas, Texas, and one Gerald L. Fossland, as stockholders of Alleghany Corporation, against that Corporation and all nine members of its Board of Directors at the time, including respondents Allan P. Kirby, Fred M. Kirby, and Charles T. Ireland, Jr. In addition, the complaint named one Randolph Phillips as a defendant (R. 88, 97, 166).

*Murchison* collaterally attacked, as to Allan P. Kirby alone, a judgment, entered three months earlier by the New York State Supreme Court (R. 2273), approving the settlement of *Zenn,* a derivative action brought in that Court (R. 2278-83). The complaint in *Zenn* was based on eight causes of action charging fraud in a number of

* We have set forth in Appendix B a list of some of the factual misstatements made by the petitioners, together with a statement as to what the record facts are.

corporate transactions involving stock or control of the New York Central Railroad, the Chesapeake & Ohio Ry. Co., and Investors Diversified Services ("IDS") (Ex. 1, R. 701-27).

The Murchisons had been defendants in *Zenn* and had secured a release and judgment soon after Kirby's judgment was entered (Ex. K-156H, R. 1733; Ex. I-42, R. 2278).

**(b) *The background of the Complaint:***

As the District Court noted, *Murchison* was a move in a campaign of corporate warfare then being waged by the Murchisons (R. 2288). Having surrendered control of IDS to Alleghany in their own settlement of *Zenn*, which became final upon the New York Supreme Court's entry on June 21, 1960 of its final judgment approving the *Zenn* settlements (Ex. I-42, R. 2273, 2281), the Murchisons began a proxy fight to wrest control of Alleghany itself (and, of course, IDS) from Kirby, its chief executive officer after the death of Young on January 25, 1958. Simultaneously, they started this derivative suit.

**(c) *The Amended Murchison Complaint:***

The Murchison proxy contest culminated in their acquisition of control of Alleghany on May 23, 1961, a control which they continued to exercise until December 4, 1963 (R. 2382). On June 26, 1962, while the Murchisons were thus in control, the complaint was amended by them to substitute Alleghany as party-plaintiff and to discontinue the action as to all Alleghany directors except those who had been their principal opponents in the Alleghany proxy battle, *i.e.*, Allan P. Kirby, Fred M. Kirby and Charles T. Ireland, Jr. (R. 2289).* Counsel who had

* Alleghany directors Charles T. Hill, Alfred E. Perlman, William G. Rabe, Joseph M. Fitzsimmons and Anthony Smith were dropped as defendants.

originally represented the Murchisons continued to prosecute the action as counsel for Alleghany.

The *Murchison* complaint, as amended in 1962, sought to set aside as to Kirby alone (1) the New York court orders and judgments approving Kirby's settlement and dismissing *Zenn* on its merits and (2) an order vacating a prior injunction of the United States District Court for the Southern District of New York entered on December 24, 1959, in another derivative action entitled *Breswick & Co., et al.* v. *Briggs, et al.*, Civ. Act. No. 98-371 (*"Breswick"*)* (R. 187-88). The *Murchison* complaint also sought leave to reassert against Kirby one of the eight claims asserted in the state court *Zenn* action (R. 188). This relief was sought on two grounds:

> (a) that in the fall of 1959 Kirby and Ireland procured the dismissal of *Zenn* through a "corrupt bargain" involving a reward to Randolph Phillips, a consultant to the objectant stockholder's counsel (R. 176-77; R. 2289);**
>
> (b) that Kirby had induced the *Zenn* Referee and Court to approve settlement of this claim by fraudulently failing to disclose during hearings in 1955 and 1956 material facts known to him early in 1950 about the financial prospects of IDS (Par. 39, R. 174-75).

The claim which the Murchisons sought leave to revive against Kirby had been the first cause of action (out of

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* Although petitioners' brief is replete with references to Breswick (cf. p. 17, "Consummation of the Settlement"), all courts below, including the dissenting judge in the Court of Appeals, agreed that the proceedings in Breswick were "unrelated to the claim here at issue" (R. 2368). The Breswick proceedings are described at pp. 45 through 50, *infra*.

**This claim comprised the original cause of action in the *Murchison* complaint, before amendment in 1962. No appeal was taken from its dismissal.

eight) in *Zenn* (Ex. 1, R. 701-28). This cause of action had attacked a transaction between Alleghany and certain of its directors, commenced in 1949 and completed in 1950 (the "1949-50 exchange"), whereby those directors had tendered to Alleghany shares of its preferred stock in exchange for its transfer to them of IDS Class A (non-voting) common shares.

**(d) *The decisions below:***

The pre-trial phases of this case were marked by extensive interrogatories and over 20,000 pages of deposition testimony from 25 witnesses, including a thorough examination of Kirby (R. 2288, 2289). On June 3, 1963, after a trial lasting from April 1 to April 19, 1963, the complaint was dismissed by the United States District Court for the Southern District of New York, Dawson, J. (R. 2328). That dismissal was affirmed by a 2-1 decision of a panel of the Court of Appeals for the Second Circuit on May 19, 1964 (R. 2370). Alleghany's Board, *including Kirby,* then voted unanimously, on the recommendation of petitioners' counsel (R. 19),* to authorize a petition for rehearing en banc (R. 2382); on January 12, 1965 the Court of Appeals, sitting en banc, affirmed the District Court by a 4-4 decision (R. 2375-77).

**(e) *The present petitioners enter:***

After almost eleven years of litigation with respect to the subject matter of this action, the independent directors of Alleghany voted unanimously, one director abstaining, not to continue the prosecution of the suit (R.

* At the time, petitioners' counsel represented Alleghany, having been retained after the corporation was substituted for the Murchisons as plaintiff.

2382-83), and so informed the Murchisons' attorneys, who represented Alleghany (R. 20).

Those attorneys then reappeared as counsel for the present petitioners and sought leave to intervene on their behalf (R. 55-56).

**(f) *The scope of the present petition:***

No appeal has ever been taken from the trial court's dismissal of the "corrupt bargain" theory (Pet. Br., p. 19*), as to which Judge Dawson found that "the evidence was all completely to the contrary" (R. 2317). However, an appeal was taken, and is now sought to be continued, from Judge Dawson's dismissal of the claim that Kirby defrauded the *Zenn* Referee and the New York State Supreme Court by not offering in evidence certain documents bearing on IDS' prospects in 1949 and 1950. Petitioners' counsel have relied on different documents at different stages of the case. At present, petitioners point to 12 as being crucial (Pet. Br., pp. 9-14). They were selected during discovery proceedings in this case, from the thousands of documents available for discovery in *Zenn*.

Because the *Zenn* suit was settled, the legality of the 1949-50 exchange and of the Alleghany proxy material used to obtain approval of it was not finally determined in *Zenn* (Ex. K-137, R. 1654). Nor has that question been tried in the instant case (R. 165-66). In appraising the fairness, reasonableness and adequacy of the settlement, however, the *Zenn* Referee took extensive testimony on the circumstances of that transaction (Ex. K-137, R. 1595). After a full review, he concluded that the complaint would be dismissed if tried on the merits (Ex. K-137, R. 1654).

* "Pet. Br." as used herein refers to "Brief for Petitioners."

## II. The Background of the 1949-50 Exchange.

### (a) *Alleghany's quest for fiscal stability:*

Alleghany was organized and conducted as a railroad holding company in 1929 (See *Alleghany Corp.* v. *Breswick & Co.*, 353 U. S. 151, 155 (1957)). When Young and Kirby purchased control in 1937, Alleghany was all but hopelessly insolvent, with a total indebtedness of over $78 million, and a growing accumulation of dividend arrears on its preferred stock (Ex. 195, R. 1015). By 1946 Alleghany had substantially reduced the debt, and turned to the financial problem represented by huge dividend arrearages on its preferred stock (Ex. 195, R. 1014).

### (b) *The ten-year recapitalization program:*

To recapitalize and eliminate these arrearages, Alleghany undertook a program of acquisition of its own outstanding preferred. This required more than ten years to accomplish. (See *Breswick & Co.* v. *United States*, 75 S. Ct. 912, 916 (1955). The program was carried out through open-market purchases of preferred, and exchanges of preferred stock for portfolio securities or issues of new preferred. The several stages of this program have been reviewed and described by the ICC, the SEC and the federal courts.*

The transaction whose validity was at issue in the *Zenn* proceedings was a step in Alleghany's recapitaliza-

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* Breswick & Co. v. United States, 134 F. Supp. 132, 135-36 (S.D.N.Y. 1955); 138 F. Supp. 123 (S.D.N.Y. 1955); *rev'd sub nom.* Alleghany Corp. v. Breswick & Co., 353 U. S. 151 (1957); Breswick & Co. v. United States, 156 F. Supp. 227, 229 (S.D.N.Y. 1957), *rev'd per curiam sub nom.* Alleghany Corp. v. Breswick & Co., 355 U. S. 415 (1958); Breswick & Co. v. United States, 160 F. Supp. 754 (S.D.N.Y. 1958); Alleghany Corp. Secs., I.C.C. Fin. Docket No. 17937 (Nov. 20, 1952), I.C.C. Fin. Docket No. 18162 (July 17, 1953), I.C.C. Fin. Docket No. 18866 (May 26, 1955); Matter of Alleghany Corp., 37 S.E.C. 424, 426 (1956).

tion program. It involved 4,840 of the 774,539 shares of Alleghany preferred stock ultimately brought into the company's treasury.

**(c) *The exchange programs of 1949:***

By early 1949 Alleghany's market purchases of its own preferred had reduced dividend arrearages by over $31 million (Ex. 195, R. 1013, 1015). In April 1949, the program was broadened through the initiation of a series of seven offers by Alleghany to retire its outstanding preferred by exchanging various securities in its portfolio for that preferred. Such offers were made in May and September, 1949 (Ex. 195, R. 1014; Ex. 199, R. 1035). In December 1949, a further list of portfolio securities to be exchanged was prepared which included several stocks recently acquired by Alleghany, such as shares of North American Company, Long Island Lighting, American Power & Light, Wheeling & Lake Erie R.R., and New York, Chicago & St. Louis R.R. (Ex. 199, R. 1034-1035).

Also on this December 1949 list for exchange were 48,225.61 Class A (non-voting) shares of IDS (Ex. 199, R. 1037).* It was the exchange of these securities with Alleghany directors in 1950 that formed the basis of the first cause of action in the *Zenn* litigation. The exchange was attacked for a number of reasons, including an alleged difference between the market price of the Alleghany and IDS shares on the date of contract performance, overreaching, defects in voting procedure, and concealment of the directors' knowledge of an improvement in IDS' earnings during the early part of 1950, reflecting a "trend" that was not revealed to Alleghany stockholders (Ex. 1, R. 704-05).

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* Pet. Br., p. 5 claims that this item was not on the agenda of the meeting. But Item 6 on the agenda dealt generally with exchange offers, and Purcell testified that this was not the first time the matter had been discussed (R. 566-67).

## III. Alleghany's Investment in IDS.

Alleghany's investment in IDS, made during April 1949, was one of its first purchases of non-railway securities (Ex. 195, R. 1016, 1018).

In 1948, brokers had approached Young and Kirby as prospective purchasers of the IDS stock (R. 416, Ex. K-137, R. 1634).

### (a) *The nature of IDS' business:*

IDS, a Minnesota corporation, had been chiefly engaged since 1894 in the sale of face-amount savings certificates, which entitled the investor to payment of a stated sum on a future maturity date. The proceeds of the investors' payments to IDS were placed in investments intended to earn enough to enable IDS to pay off the certificates as they fell due and also earn a profit for its stockholders (Ex. K-294, R. 1933-34). After 1940, IDS also became an investment advisor, providing sales and financial services to a number of mutual funds which it caused to be established (Ex. K-294, R. 1937).

### (b) *The two camps at Alleghany:*

The proposed investment was a controversial one. IDS' assets and liabilities were enormous in contrast to the relatively modest amount of capital invested by its stockholders, and it depended heavily upon its own investment program to meet its certificate commitments before it could earn any profit for its stockholders (Ex. K-294, R. 1933-34). This had the effect of giving the stock great leverage, which could result in sharply increased earnings (an event that later occurred) or, under the influence of unfavorable factors, heavy losses (Ex. K-137, R. 1638-39).

One group of Alleghany officials questioned the advisability of the investment, pointing to factors indicating that the IDS venture was risky (Ex. 300, R. 1155; Ex. K-187, R. 1851; Ex. K-221, A. 1868). In 1949 the face amount of IDS' outstanding certificates, most of which would fall due in the early 1950's, was in excess of $400 million (Ex. K-137, R. 1638; Ex. K-294, R. 1933-34; Ex. K-295, R. 1960). The company had not shown a large operating profit at any time (Ex. K-293, R. 1912), and in recent years it had faced difficulties because a substantial residue of old certificate contracts had been written at high interest rates in a period of generally declining interest rates (Ex. K-294, R. 1933-34; Ex. K-295, R. 1955-57). By 1948, for instance, IDS' investment return averaged 4.039% while the average cost of its certificate obligations was 4.452% (Ex. K-295, R. 1955). Because of the amounts involved, this deficiency would have a potentially adverse effect upon the value of the IDS stock unless it were checked or balanced by favorable factors.

The uneasiness of some high Alleghany officials was a reflection of the country's economy at the time, and the prevailingly pessimistic expectations about its future. The United States was experiencing its first post-war recession, long feared and predicted. The extraordinary expansion of the American economy over the next decade was generally unforeseen.*

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* The unforeseen growth of the economy drove the Gross National Product from $258.1 billion in 1949 to $363.1 billion in 1954 and $628.7 billion in 1964, and increased personal savings from $8.5 billion in 1949 to $18.9 billion in 1954 and $26.3 billion in 1964. In the same period, retained earnings of corporations rose from $27.6 billion in 1949 to $35.5 billion in 1954 and to $57.9 billion in 1964 (Annual Reports of the Council of Economic Advisors and Dep't of Commerce Survey of Current Business).

It was this prodigious rise in savings (unforeseeable in 1949 and early 1950) which allowed IDS, and other successful institutions through which savings are invested, to grow at least tenfold in this same period.

As against the pessimists on Alleghany's Board, there were two staff members (Purcell and Shipman) who were convinced advocates of the investment. They persuaded Alleghany's Robert R. Young to their view (Ex. K-222, R. 1870). Kirby reluctantly accepted their recommendation (R. 416).

**(c) *The acquisition is made:***

In April 1949, Alleghany purchased voting control of IDS from Bertin Gamble, the company's president, and one of his associates, paying $20 a share for 85,666 voting shares, a total of $1,715,000 (Ex. K-137, R. 1634-35). Alleghany also bought 48,225.61 non-voting shares of IDS Class A Common on the open market, at a total cost of $392,811.45, an average price of $8.15 per share (Ex. K-137, R. 1634-35, Ex. 195, R. 1019).

**(d) *Post-acquisition developments at IDS:***

After Alleghany made its investment in IDS, skepticism and uncertainty continued on the part of some Alleghany officials, including Kirby (Ex. K-353, R. 2008). Before the consummation of the 1949-50 exchange, further reports (which were in evidence and noted by the *Zenn* Referee) confirmed the speculativeness of the venture (Ex. K-295, R. 1951).

**(i) *the favorable factors:***

On the plus, or bullish, side the amount of IDS' high interest-bearing certificates was decreasing, and its Mortgage Department expected to realize substantial "windfall" earnings from favorable investments in construction and mortgage loans (Ex. K-295, R. 1954, 1958). Furthermore, there were increases in IDS' income from

fees charged for management of the investment accounts of its subsidiaries and affiliates, including its mutual funds, and from selling and servicing mortgages (Ex. K-295, R. 1953). If no downward turn developed in the general economy and if IDS did not suffer any of several possible misfortunes (described below), it would meet its contract requirements over the years and realize a steadily increasing profit as the adverse balance in its investment account decreased (Ex. K-295, R. 1958). In the latter part of 1949 and early 1950, for instance, the earnings of the company's Mortgage Department were sharply increasing and would apparently result in substantial increases in IDS' earnings (Ex. 345, R. 1189). All of this was brought to the attention of the *Zenn* Court (Ex. K-41, R. 1511).

**(ii) *the unfavorable factors:***

As against these favorable factors, there were unfavorable contingencies which could reduce, or even wipe out, the value of IDS stock (Ex. K-137, R. 1645-46). Some of these were summarized by the *Zenn* Referee (Ex. K-137, R. 1638-39) as follows:

> (1) IDS in 1949 had $400,000,000 in certificate maturities imminently due, and inadequate income and reserves to meet them.
>
> (2) IDS had a long history of difficulties with the SEC over its selling techniques.
>
> (3) The SEC was insistent on changes in IDS accounts with respect to the rate of accrual of certificate reserves and a change of its reserve accumulations to an accrual basis rather than on an annual basis.
>
> (4) There was a possibility that the holders of $15,000,000 to $25,000,000 worth of certificates would elect to rescind their purchases.

(5) The National Association of Securities Administrators was investigating IDS and had the power to put the company out of business.

(6) IDS was selling mortgages to its subsidiary at a premium and improperly taking the premium into its income account while the subsidiary capitalized it over the life of the mortgage; thus IDS books did not properly reflect its true earnings.

(7) There was a controversy between IDS and the Minnesota Banking Commission on the interpretation of the language in certificates relating to types and amounts of assets required to be maintained by IDS. Adoption of the Commission's view might well have left IDS open to receivership.

(8) The SEC was contending that IDS should carry its preferred stock portfolio at current market prices rather than cost. This would have eliminated the company's capital and surplus.

(9) The real estate operations of IDS were unsound and profits therefrom illusory.

(10) The IDS stock was not a stable security for collateral under Alleghany's bank loans.

**(iii) *the general outlook at Alleghany:***

This, then, was the picture of IDS' future confronting Alleghany in the latter part of 1949. An adverse development on any front could seriously depress the value of IDS. Kirby remained in the camp of pessimists (R. 466-67). Kirby, however, was not alone in his appraisal of the economy. The President of Brookings Institution, for instance, made the following summary, published in the Commercial and Financial Chronicle, Dec. 15, 1949, Vol. 170, p. 2385:

"The striking fact about business forecasting has been the continuous expectation of an early business recession. At the end of the war, the pessimism was wide-spread and deep seated. At the end of 1945 and again in 1947, some observers conceded the possibility of a year or more of good business; but still the keynote was usually one of confidence that a depression was overdue. At the beginning of 1949 the view became widespread that the long overdue depression was at last at hand." (Moulton, "Economic Factors Make a Severe Depression Unlikely.")*

**(e) *Alleghany hedges its position in IDS stock:***

In view of the speculative nature of its IDS investment, Alleghany's management believed that the non-voting Class A shares should be used as one of the securities in its portfolio to be offered in the course of its program for the retirement of its preferred; its non-voting IDS shares were particularly suitable for such use because their instability greatly reduced their acceptability as collateral for loans (Ex. K-137, R. 1639) and because Alleghany's disposal of them would not affect its control of IDS through its ownership of IDS voting shares (Ex. 195, R. 1018-19). Accordingly the Board in December, 1949, placed Alleghany's 48,225 Class A (non-voting) IDS shares on the exchange list, along with the various other recently-acquired portfolio securities to be offered (Ex. 215, R. 1044).

* See also Shields, "Be Ready For The Second Phase of Post War Readjustment," *op. cit. supra*, Oct. 27, 1949, Vol. 170, p. 1654; Davidson, "Factors in the Approaching Depression," *op. cit. supra*, March 23, 1950, Vol. 171, p. 1203; "They See A Slight Bust Coming," Business Week, June 10, 1950, p. 34.

**(f) *The necessity for a private offering:***

Having decided to offer IDS shares for exchange, Alleghany's Board was faced with the fact that these shares (unlike the others to be used in the program) could not be offered for exchange to Alleghany's stockholders without the filing of a Registration Statement under the Securities Act of 1933 (Ex. 199, R. 1036). Counsel advised that such a registration would be complex and would involve such delay and expense in relation to the then market value of the IDS shares involved as to make registration impracticable (Ex. 206, R. 1039; Ex. 215, R. 1044). The Board resolved, therefore, to limit the exchange to a number of persons small enough to render the exchange a private offering under the Securities Act. The only group which owned sufficient Alleghany preferred shares to enable the exchange to be made, and was also small enough to meet the SEC requirement, was Alleghany's own management, Kirby and Young being among the largest holders of preferred (Ex. 199, R. 1031-32).

**(g) *The exchange is authorized:***

On December 6, 1949, the Board approved the exchange offer and, in addition, adopted a resolution offering to exchange Alleghany's non-voting IDS shares for Alleghany preferred shares owned by officers of Alleghany at a ratio to be based on the market price of the Alleghany preferred shares tendered for exchange and upon the higher of cost or market of the IDS shares, such exchange to be subject to ratification by the stockholders of Alleghany (Ex. 206, R. 1039, 1041). At the same time, Kirby and Young committed themselves to exchange Alleghany preferred for whatever IDS shares were not exchanged

for Alleghany preferred by other Alleghany officers (Ex. K-137, R. 1651; Ex. K-254, R. 1891).

Pursuant to the offer, J. J. Anzalone, a director, exchanged 10 shares of Alleghany preferred for 100 shares of IDS. Young exchanged 2,420 shares of Alleghany preferred for 24,063 shares of IDS. Kirby exchanged 2,420 shares of Alleghany preferred for 24,062 shares of IDS (Ex. K-215, R. 1864).* Young and Kirby immediately thereafter each sold at cost to Robert W. Purcell, then an officer of Alleghany and a director of IDS, 6,336 shares of the IDS received by them in the exchange. The sale to Purcell was in fulfillment of an agreement, previously disclosed to the Alleghany stockholders, between Purcell and Alleghany (Ex. 198, R. 1029). By the terms of that agreement, Purcell was to acquire, by purchase, $125,000 of IDS stock, so that he, as Alleghany's representative at IDS, would have a direct interest in assuring its effective management (Ex. 199, R. 1033-34). As protection, in the event he left Alleghany or IDS, Purcell was given the right to put his stock to Alleghany, at his cost, for a period of five years (Ex. 198, R. 1029).

Mr. Kirby's view of the entire transaction is expressed in his testimony (R. 466-67) in the present action:

> "Q. If you didn't have confidence in it, why did you make that exchange of stock? A. It was only one of many exchanges that I made, sir. Mr. Young and I had set a policy of reducing Alleghany's debt as far as we could, and by making these exchanges of not only IDS but many other

* Kirby and a personal holding company controlled by him also exchanged 2,000 shares of prior preferred and 13,800 shares of series A preferred for shares of North American Co. and American Power Co., two of the other stocks made available as part of the December exchange program (Ex. 199, R. 1034-35).

securities that were in the portfolio we were able to reduce it.

Q. You were able to reduce— A. The capitalization. It was wiping out preferred stock.

Q. You were exchanging stock of Alleghany for stock of IDS? A. Yes, sir, preferred stock.

Q. You did that because you wanted to reduce the capitalization of Alleghany? A. Yes. We knew we would probably never benefit from Alleghany until we got the preferred stock down substantially. We even had to put out an issue of preferred stock to take care of the dividends that had accumulated on a prior issue of preferred stock. So you can see—

Q. So you had some of this preferred stock? A. Yes.

Q. You exchanged it for IDS? A. Yes.

Q. Although you thought IDS wasn't very good? A. That's right. I did not think Alleghany was very good either. I thought it was very poor, it was one of many things we were trying to work out. I couldn't see where I was hurting myself any or probably not benefiting myself any, by making these exchanges. I was only accomplishing what we set out to accomplish, and that was to reduce the debt of Alleghany in whatever way we might be able to do it."

**(h) *The market in IDS—December 1949 through May 1950:***

On December 6, 1949, when Alleghany's Board authorized the exchange, the market price of IDS Class A was $5.50 per share (Ex. 206, R. 1039, 1040). The 1949 Annual Report of Alleghany, dated March 15, 1950 (Ex. 195, R. 1010-28), was mailed to the stockholders on March 24th (Ex. 199, R. 1031). It stated, concerning the investment in IDS, that "The outlook for eventual

profits is considered to be unusually promising" (Ex. 195, R. 1018).

By March 31, 1950, the price of IDS had risen to $9.00 bid and $9.75 asked, a fact that was included in the same paragraph of the April 6, 1950 proxy statement which reported that Messrs. Kirby, Young and Anzalone had committed themselves to tender their preferred for IDS Class A on the basis of a cost of $8.1453 per IDS share (Ex. 199, R. 1037). By May 3, 1950, the date of the stockholders' meeting approving the exchange, the price was $11.00 bid, $12.00 asked (Ex. K-137, R. 1637).

(i) ***The market in IDS—June 1950 through December 1964:***

In the years following the 1949-50 exchange, IDS' management successfully resolved its problems with the regulatory authorities and took energetic advantage of the opportunity offered to it and to other savings institutions by the long surge of economic expansion following the outbreak of hostilities in Korea in June, 1950 (see fn., p. 13, *supra*).

IDS' actual earnings for the year 1949 had amounted to $1,365,485 or $4.70 per share (Ex. K-358, R. 2121, 2123). Its earnings for the six months ending June 30, 1950, amounted to $2,831,559 or $9.74 per share (Ex. K-173, R. 1807, 1809). Even after this increase in IDS' actual earnings (as distinguished from forecasts) became publicly known in the summer of 1950, the market price of IDS' stock rose to only $14.75 bid, $15.75 asked.* (See Appen-

* Petitioners repeatedly refer to the exchange as one whereby Young, Kirby and Purcell got IDS stock "worth $60,000,000." Pet. for Cert., p. 5. This is apparently based on market quotations for IDS' stock in the 1960's. It overlooks several important facts:

(1) the market value of IDS' shares continued to remain below $30 per share throughout 1950, even after the sharp increase in 1950 earnings, allegedly concealed from Alleghany

dix E for a complete chart of IDS Class A prices during the period June 1950-December 1954.)

The investing public's unwillingness to pay a price for IDS stock commensurate with its sharply increased earnings was shared by IDS' own management, which possessed detailed inside knowledge of its earnings prospects. On July 24, 1950, E. E. Crabb, the President of IDS (who was aware of the allegedly "concealed", "crucial" earnings projections that had been prepared by his company, and of the actual increase in earnings to $9.74 per share for the first six months of 1950) called on Alleghany to fulfill a prior commitment to purchase 3,034 IDS shares at $20 per share (Ex. 399, R. 1385).

The IDS Annual Report for 1950, dated April 30, 1951 and made public on May 23, 1951, disclosed that net after-tax income for the year had been $6,454,411, or $22.20 per share (Ex. K-359, R. 2135, 2145, 2146-47). Yet, by December 7, 1951, the market price of IDS stock was only $36 bid, $37.50 asked, a decline from a high of $39 bid and $41 asked on October 5, 1951 (App. E, p. 54).

The far greater increases in the market price of IDS stock, one of the factors which led to the institution in 1954 of the *Zenn* derivative stockholders' action, took place long after the information claimed to have been concealed in 1950 had become public (See App. E, pp. 51-59). It was not until the resolution of IDS' controversies

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stockholders, had become well known (Appendix ("App.") E, pp. 51-52).

(2) sharp increases in market price of many other marketable securities (including some used by Alleghany in the exchange program) occurred later in the 1950's. For example, the [illegible]t price of Xerox on Jan. 1, 1965 was 295 times its pri[illegible]n. 1, 1950.

(3) [illegible], the total assets under IDS management are in excess of $5 billion, as compared with about $500 million in 1949 and 1950.

with the SEC in 1952 (Ex. K-362, R. 2181) and the general rise in the popularity of mutual funds, that the period of IDS prosperity actually began. From 1952 to 1954, the market price of IDS stock rose from $39 per share to over $200 per share (App. E, pp. 54-59), and by the end of 1964, it had risen to over $1,262 per share.*

## IV. *Zenn* v. *Anzalone* (Sup. Ct. N. Y. Co. Index No. 7244/1954)

In 1954 various derivative stockholder actions were instituted in the New York Supreme Court against Alleghany directors, reflecting a number of controversies about the management of the company, nearly all of which had nothing to do with the 1949-50 exchange (Ex. 1, R. 705-26). The *Zenn* action, a consolidation of these suits, named all of the then directors of Alleghany (including Young and Kirby), Murchison Brothers, Clint W. Murchison, Jr., Robert W. Purcell and others (Ex. K-137, R. 1595-96). The firm of Pomerantz, Levy & Haudek was designated as plaintiffs' general counsel (R. 635-36) to prosecute the eight causes of action set forth in a consolidated amended complaint filed in July 1955 (Ex. 1, R. 701-28).

Kirby, although named as a defendant, was not served and did not appear generally in the *Zenn* action (Ex. K-292, R. 1899).

### (a) *The first cause of action:*

The first cause of action in *Zenn* alleged that at the time of the consummation of the 1949-50 exchange the

* IDS stock, Class A, was split 5 for 1 on April 23, 1954, and again on May 6, 1964, in connection with a recapitalization of both classes of IDS stock. Prices given for dates subsequent to either split are for the Class A stock, and are adjusted accordingly.

market price of the IDS shares exceeded by $290,502.44 the market price of the Alleghany preferred surrendered by Young and Kirby, and that the proxy statement for the annual meeting at which the exchange transaction was ratified was fraudulent in misstating facts and omitting to state material facts relating to improved earnings of IDS and to the prospective favorable developments in IDS "foreseeable to and foreseen by" the Alleghany directors (Ex. 1, R. 704), and was, in addition, defective under the Securities Exchange Act and the proxy rules of the Securities and Exchange Commission (Ex. 1, R. 705).

The complaint sought rescission of the exchange transaction or, in the alternative, recovery of the alleged difference in market price (Ex. 1, R. 724-26).

**(b) *The second through eighth causes of action:***

Substantially all of the other seven causes of action in *Zenn* were based on transactions between Alleghany and the Murchisons, and charged the Murchisons with being jointly and severally liable with Young, Kirby, and other Alleghany directors (Ex. 1, R. 705-26). These are summarized in the Referee's Report in *Zenn* (Ex. K-137, R. 1599-1609).

**V. *Zenn* v. *Anzalone (federal):***

The stockholder plaintiffs in *Zenn* filed a companion action in the federal District Court, which petitioners' brief confuses with *Breswick* v. *Briggs,* filed in the federal District Court by another group of stockholders, and discussed at pp. 45-50, *infra.* Like the state court case, federal *Zenn* was captioned *Zenn, et al.* v. *Anzalone, et al.* The depositions of Young, and of David Wallace, the Secretary of Alleghany were taken in federal *Zenn*

during 1954 and 1955 (Ex. 356A, R. 1313; Ex. K-137, R. 1621). The deposition of Young was concluded on March 30, 1955 (Ex. K-137, R. 1621) and since that date, more than five months before the state court's appointment of the *Zenn* Referee (Ex. 3, R. 741), federal *Zenn* has been dormant. The parties plaintiff chose the state court *Zenn* as the vehicle for their proceedings (Ex. K-137, R. 1623). In view of the settlement of the state court *Zenn,* and the vacatur of the injunction in *Breswick* (see pp. 49-51, *infra*), there has been no occasion to pursue federal *Zenn.*

Petitioners in their brief frequently refer merely to the "federal court action", without distinguishing between *Breswick* and *Zenn.* This practice can mislead a reader into thinking that some event in the history of *Breswick* v. *Briggs* actually took place in the federal *Zenn* litigation. The difference is important, since the *Breswick* litigation did not involve the 1949-50 exchange, and the *Breswick* court would have had no interest in any evidence bearing on that transaction. For instance, there appears at page 18 of petitioners' brief the following:

> "The federal district court, like the plaintiffs, was still unaware of the inside information which Kirby, Young and Purcell had possessed, nor was it told of Young's perjury[*] or that Ireland, who was now representing Alleghany, had negotiated Kirby's settlement. It approved the settlement and lifted the injunction [citations omitted].
>
> "Defendants then went to the state court and obtained the judgment under attack here. The federal court action is still on the calendar [*Zenn* v. *Anzalone* (S.D.N.Y. Civ. No. 92-205)].

* "Young's perjury" is a charge so serious and so misleading as to warrant separate treatment. It is fully discussed at pp. 37-40, *infra.*

For present purposes, suffice it to note that the "federal district court" referred to in the first paragraph quoted above is the *Breswick* court not the *Zenn* (federal) court; and that the District Court never "approved the settlement," because the 1949-50 exchange was not involved in *Breswick* (R. 495) and *Zenn* (federal) has been dormant. For a statement of what the *Breswick* court did do, see pp. 49-50, *infra*).

In any event, this is not an appeal from the judgment of a federal district court; the judgment under attack here is a state court judgment and the attack on that judgment is a collateral attack in an independent action. All references hereafter made to *"Zenn"* in this brief, unless noted as "federal", are to the proceedings in the New York State Supreme Court.

**VI. The Initial Settlement of *Zenn*:**

After the completion of the depositions of Young and Wallace in federal *Zenn* a series of thirteen or fourteen settlement conferences resulted, on April 18, 1955, in a stipulation of settlement covering all claims being asserted in pending derivative actions and providing for the payment of $700,000 cash to Alleghany and for the amendment of certain joint venture contracts between Alleghany and the Murchisons (Ex. K-137, R. 1622).

The settlement was embodied in a stipulation of settlement dated July 25, 1955, which was presented for approval to the New York State Supreme Court (Ex. 2, R. 729). David Wallace executed this stipulation as attorney-in-fact for eleven named defendants who had not been served (Ex. 2, R. 736). Kirby was one of these. Other than the execution of that document, Wallace at no time during the *Zenn* proceedings had any authority in any way

to act for, speak for, or represent Kirby and the other unserved director-defendants, and at no time undertook to do so (Ex. K-137, R. 1713-16; Ex. K-353, R. 1984-89).

**(a) *The submission to the New York Supreme Court:***

With respect to the decision to present the settlement to the state court for approval, the Referee made the following observations (Ex. K-137, R. 1623):

> "At no time up to and including April 18th, 1955 was the procedural method of carrying the settlement into effect discussed. Whether the settlement would be submitted to the State Court or to the Federal Court, or whether any motions would subsequently be made to amend Complaints in cases then pending, so as to present a complete statement of all derivative claims in one consolidated Amended Complaint, was a matter left entirely for later discussion between counsel . . . .
>
> • • • • •
>
> "There can be no question that the consolidated Amended Complaint in the State Court action, in July, 1955, was the most comprehensive pleading in either the Federal or State Court. Under the circumstances, I find it altogether reasonable that application for approval of the settlement was made to this Court rather than to the Federal Court."

**(b) *The appointment of a Referee:***

In July, 1955 Alleghany (but *not* Kirby, Young or Purcell) moved in the New York Supreme Court for approval of the proposed settlement (Ex. 3, R. 741). On August 18, 1955 the court appointed the Hon. Robert J. Fitzsimmons as Referee and directed him "to inquire on the merits into the fairness, reasonableness and adequacy of a stipulation of settlement dated July 25, 1955, and to

report as to whether or not said proposed settlement, should be approved and confirmed" (Ex. 3, R. 742). Notice of the terms of the proposed settlement was mailed to all stockholders of record of Alleghany advising them of the proposed settlement and notifying them of their right to attend and be heard (Ex. 3, R. 742, 745). Hearings on the settlement commenced on September 19, 1955 (Ex. K-137, R. 1593).

The hearings before the Referee were described as follows by the Court of Appeals:

> "[T]here was vigorous opposition to the settlement. Many of the arguments now advanced were urged as reasons for rejecting the settlement. Counsel (Seymour Graubard of Graubard & Moscovitz) for one objectant (Rosen) in particular worked in close association with counsel in *Breswick*. The statistics as to the nature and duration of the hearing are revealing. Eighteen witnesses were called, some 480 exhibits introduced, over 4,600 pages of testimony were taken and twenty-two law firms and attorneys appeared. The hearing on the merits of the settlement was, in effect, a hearing on the merits of the suits." (R. 2333)

**VII. The *Zenn* Hearings:**

**(a) *The evidence before the Referee:***

With respect to the one *Zenn* cause of action based on the 1949-50 exchange, the Referee stated:

> "The principal attack is directed to defendants' alleged failure to make adequate revelation to the shareholders of Alleghany, in the proxy statement soliciting their approval, as to the alleged sharp upward turn in the profits of IDS and the further improvement of future earnings which it is claimed was foreseen by Young, Kirby and Purcell." (Ex. K-137, R. 1641)

On the issue as he had stated it, the *Zenn* Referee had before him over 150 exhibits relating to the 1949-50 exchange, including a complete and detailed financial history of IDS' operations and earnings for the six years 1948 through 1953 (Ex. 195, R. 1011; Ex. K-162, R. 1739; Ex. K-172, R. 1782; Ex. K-173, R. 1804; Ex. K-174, R. 1818; Ex. K-175, R. 1832; Ex. K-176, R. 1833; Ex. K-179, R. 1834; Ex. K-182, R. 1842; Ex. K-310, R. 1980; Ex. K-311, R. 1982; Ex. K-358, R. 2115; Ex. K-359, R. 2133; Ex. K-361, R. 2156; Ex. K-362, R. 2178; Ex. K-363, R. 2204; Ex. K-364, R. 2234; Ex. K-365, R. 2254).

Included in the foregoing list are annual and semi-annual reports of IDS in each of which the actuarial work being done for IDS by the New York actuarial firm of Joseph Froggatt & Co. is mentioned and described, see Ex. K-162, R. 1747; Ex. K-358, R. 2125; Ex. K-359, R. 2148; Ex. K-361, R. 2171; Ex. K-172, R. 1789; Ex. K-173, R. 1812; Ex. K-174, R. 1824. The work of Froggatt was scarcely "concealed", yet petitioners claim that Ex. 220, R. 1053, a Froggatt report dated April 29, 1949 was one of the documents "concealed".*

The Referee also had before him a report made by Charles Shipman, Alleghany's analyst, in anticipation of Alleghany's original acquisition of IDS (Ex. K-294, R. 1933). Shipman forecast that assuming no improvement in the return on IDS' investment and no significant change in its underwriting fees, its consolidated net income would go from a deficit of $159,475 in 1947 to a profit of $5,090,850 in 1956, which would amount to more than $18 per IDS share (Ex. K-294, R. 1944-45). In a later analysis, dated August 15, 1949 (also introduced in *Zenn*, Shipman con-

* We deal with this document in Point I, pp. 86-87, as to Kirby and in Point IV, p. 129, as to Young and Purcell.

cluded, in a section entitled "The Favorable Side of the Earnings Picture," that: (1) earnings for 1949 would be "in the neighborhood of $1,200,000 to $1,500,000 as compared with consolidated earnings of less than $400,000 in 1948"; (2) because of the construction loan profits then being realized, the forecast for 1950 earnings "seemed to be up a good deal"; and (3) "there should be a substantial carryover of the extraordinary profits into 1951" (Ex. K-295, R. 1957-58). Shipman then stated:

> *"Looking further ahead, there is a distinctly favorable factor to reckon upon. As the amount of outstanding IDS certificates is reduced, the dollar amount of the adverse balance in investment account (cost of certificate money less income on investments) will decrease. It will decrease substantially year by year beginning with 1951. This means that there will be a progressively smaller drain upon the profits from Management and Sales activities. The effect upon net results will be dynamic. Management profits seem certain to continue growing. Profits from selling activities are bound to be large regardless of sales trends."* (Ex. K-295, R. 1958) (Emphasis in original.)

The Referee was shown that by February 1950, Purcell had received IDS forecasts informing him that IDS' net operating income in 1950 would jump to at least $20.00 a share—(it actually turned out to be over $[illegible].00 per share (K-359, R. 2145, 2146)); and that, under date of February 11, 1950, Purcell furnished this information in a five-page report to Young, Chairman of Alleghany, and to Kirby, President of Alleghany (Ex. 345, R. 1186). Purcell himself was at this time Vice-Chairman of Alleghany and had been put on IDS' Board by Young and Kirby and given principal responsibility for keeping in close touch with IDS' affairs (R. 537, 540; Ex. 199, R. 1033-34).

Purcell's report of February 11, 1950 (Ex. 345, R. 1186) reviewed the major accomplishments during Alleghany's first nine months of control of IDS and then dealt with the outlook for the coming year. After noting the necessity for increasing IDS' reserves by $4,300,000 to correct one aspect of the deficiency claimed by the SEC, it acquainted Young and Kirby with the fact that a steady upward surge was taking place in all of IDS' departments.* He stated that IDS was conservatively forecasting that in 1950 the Mortgage Department alone would realize a net income of $5,720,000. He pointed to the favorable trend in IDS' return on investments (Investment and Certificate Servicing Department), which had already increased from 4.336% to 4.469%, or, if construction loans were included, from 4.361% to 4.629%. He noted the increase in fund sales (Management Operations Department and Distribution Operations Department) from $42 million to $52 million and said "that we will see a similar increase in certificate sales," which would automatically increase IDS' income from underwriting and management fees.** Purcell wrote:

> "Sales, both of certificates and of fund shares, are running well ahead of last year. I think there will be over $52,000,000 of fund sales compared to $42,000,000 last year, and that we will see a similar increase in certificate sales.
>
> "The Mortgage Department operations promise to show continued substantial earnings. During 1949 the department funded $153,000,000 of new loans, of which $107,000,000 were sold to others.

* IDS' four departments were: (1) Mortgage; (2) Investments and Certificate Servicing; (3) Management Operations, and (4) Distribution Operations.

** This information, produced before the Referee, appears to have been overlooked by Judge Friendly in his dissent.

> At year end $125,000,000 of new loans were committed to be funded in 1950. Gross income from market operations was $4,487,000 (not including interest), leaving net income before home office expense of $2,277,000. As a result of the transactions the over-all interest rate on permanent portfolio mortgages was increased from 4.336% to 4.469%, and if construction loans are included, the over-all interest rate was increased from 4.361% to 4.629%, resulting in approximately $500,000 additional annual interest collected.
>
> "During 1950 the Mortgage Department forecasts,* conservatively, $8,315,000 gross income from mortgage operations (not including interest), with a net before home office expenses, of $5,720,000. I am told that these are very conservative estimates and take into account only business which is presently on the books." (Ex. 345, R. 1188-89)**

None of the IDS forecasts or projections (including those claimed by petitioners to have been "concealed") calculated projected earnings on a per share basis.† The

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* This was one of the several types of IDS earnings forecasts made known and available to the *Zenn* objectants.

** Despite Purcell's optimistic forecast there remained the risk of course, that any one of the unfavorable factors noted above (pp. 15-16) might depress the value of IDS' stock. Such business forecasts, therefore, whether "bullish" or "bearish", were of limited value. They are sometimes described by economists as "economic astrology", an indication of their circumscribed utility (see *e.g.*, N. Y. Times, March 28, 1950, p. 40, Col. 7, quoting economist Q. Forrest Walker). The IDS Mortgage Department, as late as April 25, 1950, made the following statement about the future: "Mortgage Division estimates income next three months of $1,400,000. *Because there are so many governing factors the estimate given cannot be considered as more than a guess.*" (Ex. 351, R. 1208, 1211) (Emphasis added.)

† Petitioners' brief (p. 12) gives the erroneous impression that "projected earnings per share" were shown on IDS' projections, whereas the figures per share actually represent calculations made by them for this appeal, in which they have disregarded substantial deductions (*e.g.*, losses on sale of investments) before arriving at their inflated figures per share.

figures disclosed in Purcell's report, divided by IDS' issued shares, forecast IDS' 1950 earnings at $19.61 per share from Mortgage Department income alone, plus the additional income from the surge he reported for its other three departments (Ex. 345, R. 1186).

Both Purcell and Young were called and testified at length before the Referee, being questioned as to both favorable and unfavorable factors at the time of the 1949-50 exchange. Young was Chairman of the Board and chief executive officer of Alleghany (R. 479-80); Purcell, a former officer and director of Alleghany was, at the time he testified, a director of IDS and former Chairman of its Board and President (R. 578). Both Purcell's and Young's files on IDS were produced and made available to counsel for the objectants (Ex. K-353, R. 2055; Ex. K-355, R. 2083).

**(b) *The projection evidence before the Zenn Referee:***

The main thrust of petitioners' case here is based on the alleged concealment by Kirby (who was not served, not asked to produce documents and who did not testify in *Zenn*) of favorable IDS projections and of clues which would indicate the existence of such projections. Following petitioners' failure of proof before the District Court, petitioners sought to change the theory of the case and hold Kirby liable for alleged concealments by Young and Purcell.

In Point I of our argument (pp. 79-93, *infra*), we review in detail those documents which plaintiff in the District Court claimed that Kirby "concealed". In Point IV (pp. 111-151, *infra*) we review those documents* which

* We shall not repeat here the detailed analyses there made or the conclusions presented beyond stating that there is no evidence of "concealment" by anyone and that the documents themselves are irrelevant or cumulative or both.

petitioners, as part of the new claim made for the first time on appeal, charge that Young and Purcell concealed.

We wish here merely to list and describe briefly the substantial number of forecasts and clues as to the existence of forecasts which were before the *Zenn* Referee.

**(i) *exhibits before the Zenn Referee:***

**Ex. K-295, R. 1951:**

This report, made on August 15, 1949, was prepared by Shipman after Alleghany had acquired control of IDS. Under the heading "Earnings Prospect Versus Reserve Requirements," Shipman reported that "According to the latest actuarial study by Joseph Froggatt & Company, Inc., dated April 29, 1949,* 'an earnings rate of 4.864% would be required on the dollar amount of reserves maintained by the Company at December 31, 1948, to meet its maturities and other contract requirements'" (R. 1958).

Under the heading "Projection of Money Flow," he set forth in full "a presentation of the [IDS] accounting department's estimates of cash receipts and disbursements by years for 1950-1959 inclusive" (R. 1960)

**Ex. 345, R. 1189:**

This report from Purcell, dated February 11, 1950, forecasts increased income in 1950 for each of the four operating departments of IDS. It refers specifically to a projection prepared by the Mortgage Department.

**Ex. K-293, R. 1906:**

This report, by the Cleveland investment firm of Saunders, Stiver & Co., refers to the fact that IDS first

* Thus, specifically referring by name and date to one of the documents whose existence petitioners say was "concealed" from the *Zenn* court (Pet. Br., pp. 11-12).

began to use actuarial studies in 1943 (R. 1907) and that one of the functions of the actuarial reports was to project the "income rate of return" of IDS (R-1920, 1923).

**Ex. K-294, R. 1933:**

This report, dated April 7, 1949 was prepared by Charles Shipman, Alleghany's securities analyst. Under the heading "Projection of Earnings," Shipman sets forth the amounts of income projected for the ten-year period 1947-1956 (R. 1945). He states that this table of earnings is taken from "the official projection as presented to the SEC" (R. 1944).

**Ex. K-354, R. 2060:**

This letter from the Comptroller of IDS, dated August 2, 1955, reports that in August 1949, Young received the Monthly Summary of Operations not only for IDS, but for two of its subsidiaries, ISA and ISC (R. 2060-2061). Ex. 365 *id,* which the dissenting opinion in the Court of Appeals found to be so crucial (R. 2352-54, 2359-60), had attached to it the Summary of Operations for the year 1950.

**Zenn Ex. 356 TTT:**

This IDS document is a "Comparison of Actual Cash Receipt and Disbursement Transactions to the Estimated

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* Reprinted as Appendix D hereto. It was not introduced at the trial, since there was nothing to show that Kirby had ever received IDS internal projections and since the receipt and "concealment" of those projections by Young and Purcell was not an issue. This Court, however, may judicially notice it as part of the record in related proceedings. Craemer v. Washington, 168 U. S. 124, 129 (1897); National Fire Ins. Co. v. Thompson, 281 U. S. 331, 336 (1930); Alexander v. Hillman, 296 U. S. 222, 231n. (1935).

Cash Receipts and Disbursements from January 1, 1950 through July 31, 1950." In physical appearance, it is similar to Ex. 365 *id.*, which Judge Friendly found to be such a crucial clue to the existence of projections.

**(ii) *testimony before the Zenn Referee:***

Both Young and Purcell testified before the Referee. Prior to Young's appearance, his deposition in federal *Zenn* was marked as Ex. 4 before the state court Referee (Ex. 356, R. 1220). During that deposition, he had testified as follows with respect to IDS earnings projections and forecasts:

> "A. I am sure that I received projections, from time to time, of funds available for the meeting of the certificate reserves.
>
> "Q. I think you have referred to those, Mr. Young, and I would ask you to put that particular problem aside for a minute, and to turn to the question of earnings forecasts, such as forecasts of earnings from mortgage operations.
>
> "A. I think I received such forecasts as I did of sales and all other activities of the company.
>
> "Q. Do you have any recollection at what time these forecasts were made?
>
> "A. I think they were made currently, as part of the corporation's regular routine.
>
> "Q. When you say 'currently' would you say from month-to-month?
>
> "A. I would say once a year that the company would make a projection of the outlook over a period of 5 years.
>
> "Q. When you speak of a period of 5 years, you are probably again referring now to maturities as they would be met?
>
> "A. Maturities and income and sales and all the activities of the company, a normal budgetary program which most well-run campanies have." (App. C, pp. 42-44)

When Purcell appeared before the Referee, he brought with him "all of my files and reports and everything that I could, and I remember coming into the courtroom with an enormous briefcase in one hand and a great enormous red manila folder under my other arm . . . ." (R. 580). At the outset of Purcell's one day's testimony, Graubard (objectants' counsel) examined these IDS reports for a "few minutes" (R. 1989). Concerning them, Purcell testified below (R. 596) that:

> "I know that Mr. Graubard reviewed some of the items which I brought and some others, a large number of the other items I brought, and nobody asked me about, although they were there and I had tendered them to Mr. Graubard. There were both files and financial statements and projections and reports and matters of that character."*

The accuracy of Purcell's recollection that it was his practice "to keep those projections" (R. 598, 600) is attested to by the following statement made by him at the completion of his testimony before the Referee in *Zenn:*

> "This company [IDS] produces a very large number of reports, many of which I brought here today, that nobody has asked me about." (Ex. K-353, R. 2055)

**(c) *The so-called Young "perjury:***

The alleged "perjury" of Robert Young is referred to by petitioners in three places (Pet. Br., pp. 17, 39 and 40, n. 44). For instance, at page 39, petitioners state that:

> "Neither Kirby nor Ireland disclosed that Ireland now knew, and had informed Kirby, that Young had given perjured testimony during the earlier hearings (R. 417)."

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* He testified "I am *sure* that I produced the 1955 projections, and those projections were normally for five years in advance." (R. 600) (Emphasis added.)

Perjury is a crime punishable in New York State, by imprisonment for a period up to seven years and a fine in the event financial gain has been realized from the felony (N. Y. Revised Penal Code §§70(2)(d), 210.15).* Accusations that such a serious crime has been committed should not be made lightly.

Petitioners' basis for the charge is a deposition statement by William Eppler that Kirby had been told by Ireland "that Mr. Young had perjured himself" (R. 417). This assumes more than ordinary significance here because the reference to "perjury" was quoted by Judge Friendly in his dissent (R. 2359-2360, fn. 3) in support of his conclusion that the *Zenn* Referee had been misled. The record reveals, however,

> (1) that the "perjury" had nothing to do with the 1949-1950 Exchange but related to a "put" agreement between Alleghany and the Murchisons, which had been the subject of an examination of Young, in a case called *Young* v. *Ebbott,* by Henry J. Friendly, Esq., prior to his appointment to the Court of Appeals (See App. F, pp. 60-63); and
>
> (2) that Eppler was testifying here to what he had been told by Kirby and/or Ireland, that Ireland had been told by Phillips that, *in Phillips' opinion and based on Phillips' interpretation of Young's testimony in an earlier action,* Phillips thought he could prove that Young had perjured himself.**

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* The Revised Penal Code, enacted in 1965, will not become effective until September 1, 1967. The present law provides a penalty of up to five years imprisonment (N. Y. Penal Law §1633).

** Petitioners' counsel, who now accepts Phillips as credible for the purpose of claiming perjury against Young, signed the complaint in this action, which alleges (Par. 52, R. 183),

> "(a) that Phillips had been a chronic litigator and in the course of several such litigations had made wild, reckless and defamatory charges against the directors of numerous corporations (including Kirby himself) . . ."

The ultimate basis for this charge was explained by Phillips (R. 485) at the trial below:

> "That was the evidence I referred to yesterday, that when Mr. Young testified in Young *v.* Ebbott, he had testified truthfully under examination by then attorney Henry Friendly that there was an unconditional put by Alleghany Corporation to Clint Murchison, Sr. However, Mr. Pomerantz never discovered that testimony and when Mr. Young was deposed a year later in Zenn *v.* Anzalone by Mr. Pomerantz, Mr. Young under oath stated he had never seen the put agreement, that it was not unconditional—I am giving it in substance—and that the agreement was drawn up by his green staff at that time. I had read that testimony. I informed Mr. Graubard of both the Young *v.* Ebbott testimony and the Zenn *v.* Anzalone testimony. There came a time when Mr. Young was put on the stand in Zenn *v.* Anzalone where he adhered to his later testimony and was not confronted with the Young *v* Ebbott testimony."

Neither Eppler nor Phillips was an attorney. However, Thomas Daly, Young's attorney in both *Young* v. *Ebbott* and *Zenn* v. *Anzalone,* testified, under pre-trial examination by petitioners' counsel as follows:

> "A. I remember a conversation with Mr. Ireland, or maybe it was more than one, I don't recall, and I don't recall the date of it, except it was sometime in this period, in which he reported to me that Phillips, if the hearings went on, would be able to show that Mr. Young had perjured himself in his testimony, I think it was in the Young against Ebbott suit, in connection with the put, and I told Mr. Ireland that I knew all about that testimony, there was nothing to worry about it, and it was just

some more of Mr. Phillips trying to scare him. That is the conversation as I remember it, the substance of it." (Dep., p. 52)

Daly, a lawyer, did not think the perjury charge had any substance. His opinion was, moreover, based on a first hand knowledge of the facts. The trancript of testimony on the day when Young was examined in *Young* v. *Ebbott* by Friendly shows that Daly was present.* Daly was also present during the *Zenn* hearings. The contrast is indeed sharp between the considered opinion of an experienced trial attorney and petitioners' *only* basis for this serious charge, Eppler's hearsay report of Phillips' interpretation of Young's testimony.

**VIII. The Referee's Report in *Zenn:***

On November 17, 1958, the Referee filed with the Supreme Court his 125-page report which, after reviewing the facts, gave an appraisal of the merits of each of the eight causes of action asserted and recommended approval of the settlement (Ex. K-137, R. 1592-1716).

Proceeding to the first cause of action (which attacked the 1949-50 exchange), he considered at the outset objections to the jurisdiction of the New York Court based on §27 of the Securities Exchange Act (Ex. K-137, R. 1640-41). Based on his evaluation of the complaint and of the testimony he had heard, the Referee described the §27 claims as "a mere excrescence or superfluity, tacked on to what are otherwise sufficient allegations of a claim for relief under New York Law" (Ex. K-137, R. 1641). He noted, moreover, that the same objections had already

* See, for instance, the exchange of counsel when Mr. Friendly attempted to go beyond the issues in *Young* v. *Ebbott* and to interrogate Young with respect to the 1949 IDS exchange. (Appendix F, pp. 60-63, *infra.*)

been presented to and rejected by both the New York Supreme Court and the Appellate Division thereof, and that no further appeal had been taken from those decisions (Ex. K-137, R. 1640).

On the merits of the allegations made in the first cause of action, two views were urged on the Referee. According to one, a group of responsible directors of Alleghany, acting well within the teaching of *Meinhard* v. *Salmon,* 249 N. Y. 458, 164 N.E. 545 (1928), helped their company to reduce its burden of preferred dividend arrearages by surrendering some of their Alleghany preferred for a number of Alleghany portfolio shares, including the promising but still speculative IDS stock. That stock might go up or down in value, depending on whether favorable or unfavorable events later materialized. In the meantime, it could not be used by Alleghany's Treasurer as collateral for bank loans (Ex. K-137, R. 1639) and it could not be included in the larger tender to stockholders without a costly SEC Registration Statement, which would involve difficulty and delay (Ex. 206, R. 1039; Ex. 215, R. 1044).

Disclosing their interest to the directors (Ex. 206, R. 1039; Ex. K-208, R. 1853), and their transaction to the stockholders (Ex. 199, R. 1036; Ex. 198, R. 1029; Ex. 215, R. 1046-47), they met all the tests of fiduciary responsibility imposed by the laws of Maryland, New York, and the United States.

The other view is that so strongly urged in Judge Friendly's later dissent: that members of Alleghany's Board, possessed of secret information about the future, conspired to despoil it of some IDS stock they had just helped Alleghany decide to buy, and that they concealed, or failed to disclose, its recent earnings and earnings prospects on which they had relied in making their decision.

The Referee's opinion, based on his analysis of 4,600 pages of testimony given by eighteen witnesses observed by him, together with some 480 exhibits is, however, the only opinion on the merits of the *Zenn* claim which rests on the foundation of something like a trial:

> "The merits and demerits of the claims have been presented with a thoroughness worthy of a sharply contested trial on the merits rather than a settlement hearing.
>
> "While I am not called upon to reach a final and definite conclusion as to the foreseeable success or failure of the first cause of action, it is my considered opinion that the substantial defenses above reviewed militate against the probability of success, and warrant the conclusion that a trial court would give judgment to the defendants on the merits and a fortiori, on the claim for rescission." (Ex. K-137, R. 1654)

In reaching this conclusion the Referee noted:

> "Even if we assume that Young and Kirby in April 1950, had reason to take a very optimistic view of the future earnings of IDS, this does not lead to a finding that Young and Kirby withheld material information from the stockholders of Alleghany. They did tell the stockholders in the annual report for 1949 that the outlook for future earnings was 'unusually promising.' Any attempt at more concrete prediction might well have been foolhardy. It is a common experience that the hope for future earnings improvements, however sound they may appear at the moment, is often disappointed by the event." (Ex. K-137, R. 1645)
>
> ". . . We must further consider that any specific predictions which Young and Kirby might have made concerning the future earnings of IDS would be read not only by the stockholders of Alleghany

but by the public at large, and that in reliance on such predictions many persons might have been induced to invest large amounts of money in the stocks of Alleghany and IDS. If the rosy predictions of Young and Kirby should subsequently not materalize, they and Alleghany might have been exposed to a huge claim for damages by disappointed investors. (See Sec. 18 of the Securities Exchange Act)." (Ex. K-137, R. 1645-46)

"I find therefore that Young and Kirby went to the limit of permissible predictions of the future when they stated in the annual report for 1949 that the outlook for eventual profits in IDS was considered to be unusually promising.

"Taking a broad view of the situation, it seems to me that the documentary record stating and even overstating the recent prosperity of IDS and the frank expression of hope for an unusually promising future, negate the contention of general counsel for plaintiffs and objectants that Young and Kirby did not adequately inform the stockholders of Alleghany of IDS future prospects." (Ex. K-137, R. 1646)

## IX. New York Supreme Court Confirmation of the Referee's Report and Approval of the Settlement:

The objectant Rosen filed exceptions to the report. Thereafter extensive briefs were filed with the New York Supreme Court in opposition to and in support of confirmation of the report (Ex. K-41, R. 1495). Mr. Graubard, counsel for Rosen, argued to the state court that the record before the Referee clearly established that Young and Kirby had inside information which was not revealed to the stockholders:

"On February 11, 1950, Purcell wrote a letter (Ex. 327)* to Young and Kirby. That letter set forth in detail a summary of the substantial improvements in the operations of IDS which occurred during 1949. Specifically it reported that enough mortgage business for 1950 had already been booked in 1949 to add an additional $5,500,000 to IDS' earnings in 1950.

"In addition, Purcell reported a substantial increase in IDS certificate and fund sales, an increase in the overall net rate of interest IDS received, a substantial reduction of overhead expense, and the organization of a new Canadian subsidiary to begin operations in 1950. He also reported that IDS would soon be in a position to make proper accruals for certificate reserves and thereby end its major difficulties with the SEC." (Ex. K-41, R. 1509-10)

"Did the defendants have reason to believe late in 1949 or early in 1950 when they took the IDS Class A stock that these substantial earnings would continue and in fact spectacularly increase? Exhibit 327 conclusively establishes that they did. It is a personal letter from Purcell to Young and Kirby dated February 11, 1950." (Ex. K-41, R. 1519)

On March 12, 1959 the Supreme Court approved the Referee's report, adopting it as the opinion of the court. The court noted that it was called on to weigh "the benefits held forth by the agreement of settlement against benefits dependent on the likelihood of recovery . . . keeping in mind that agreements of compromise are generally favored by the courts," and that it had had the benefit of a "lucid, painstaking and comprehensive report of a Referee achieved after protracted hearings which more nearly resembled a trial on the merits . . ." (Ex. K-138, R. 1718, 1719).

* Ex. 345 herein, R. 1186.

The Supreme Court found that the stipulation of settlement was fair and reasonable, was negotiated at arm's length, was free from fraud and collusion, and was in the best interests of Alleghany and its stockholders (Ex. K-138, R. 1720). The court pointed out, however, that an injunction order which had earlier been entered in a pending suit in the United States District Court for the Southern District of New York, entitled *Breswick & Co.* v. *Briggs,* remained as an impediment to the conclusion of any settlement in *Zenn* and to the delivery of a general release, and therefore directed that no order should be entered on its decision until it was advised that the *Breswick* injunction had been vacated (Ex. K-138, R. 1720).

### X. *Breswick* v. *Briggs (S.D.N.Y.* Civil Action No. 98-371)

On February 14, 1955, while the *Zenn* suit was pending in the New York Supreme Court, the *Breswick* action was commenced as an Alleghany stockholders' derivative suit against fourteen Alleghany directors (including Young and Kirby but not Purcell) and the Murchisons in the United States District Court for the Southern District of New York. Although the complaint in that action was later amended to incorporate some of the claims already alleged in the consolidated amended complaint in *Zenn,* it did not at any stage include any claim with respect to the 1949-50 exchange.

Counsel for the plaintiffs in *Breswick* was George Brussel, Jr., of the firm of Rosston, Hort & Brussel. Randolph Phillips was a financial consultant to Brussel.

### XI. The *Breswick* injunction of October 27, 1955, and its Effect on the *Zenn* Proceeding:

After the announcement on July 28, 1955 of the proposed settlement of *Zenn,* the District Court, on October

27, 1955, granted a motion by the *Breswick* plaintiffs to enjoin the *Breswick* defendants from "interposing in this [*Breswick*] action any defense based upon any judgment entered in any action other than this action, pursuant to any agreement not negotiated with the [*Breswick*] plaintiffs or their attorneys . . ." on the ground that the *Breswick* plaintiffs (whose complaint contained many of the same causes of action as in *Zenn*) had been improperly excluded from the *Zenn* settlement negotiations which would have disposed of those claims in *Breswick* that were also asserted in *Zenn* (Ex. 20, R. 798).

The injunction in no way derived from any claim based on the 1949-50 exchange, which was not asserted in *Breswick* (R. 386; Ex. K-137, R. 1611). Its sole purpose was to protect the bargaining position of the *Breswick* plaintiffs as to their causes of action.*

At the suggestion of the District Court in *Breswick,* the defendants engaged in settlement conferences with the *Breswick* plaintiffs (Ex. 21, R. 814). The defendants increased their cash offer from $700,000 to $1,000,000 and the Murchisons offered to return to Alleghany control of IDS (Ex. 22, R. 842-44), which they had acquired in 1954 and 1955 through an exchange of Alleghany's voting stock of IDS for their non-voting stock of IDS (Ex. K-137, R. 1603). This became known as the "Basic Settlement."

The *Breswick* defendants thereupon moved to vacate the injunction, and the District Court appointed Mr. Fitzsimmons, the *Zenn* Referee, as Special Master in *Breswick* (Ex. 20, R. 799). Hearings were held by the Special Master between October 30, 1956 and November 16, 1956. Some 675 pages of testimony were taken, relating primarily to the good faith of the settlement negotiations which had taken place between the defendants and Brussel

* Unreported opinion of Hon. John W. Clancy, U.S.D.J., in *Breswick* v. *Briggs,* Civ. Act No. 98-371, S.D.N.Y., Nov. 1, 1955.

(counsel for the *Breswick* plaintiffs) during the preceding spring and summer (Ex. 22, R. 841).

In June of 1958 the Referee, before submitting his report in *Zenn,* held two further hearings in *Zenn* in which the terms of the Basic Settlement were incorporated in the settlement offer for *Zenn* (R. 2337).

## XII. Judge Dimock's Rejection of the Special Master's Report in *Breswick,* the Negotiation of Kirby's Separate *Zenn* Settlement and Consent Vacatur of the *Breswick* Injunction:

On November 17, 1958, the same day on which he submitted his report in *Zenn* to the New York Supreme Court, Fitzsimmons submitted his report as Special Master to the District Court in *Breswick,* reporting that the *Breswick* defendants had negotiated in good faith with the plaintiffs and recommending that the October 27, 1955 injunction be lifted (Ex. 22, R. 854).

### (a) *The order of Judge Dimock:*

On September 22, 1959, Judge Dimock rejected the Special Master's report on the ground that the Special Master, in addition to finding that the defendants had conducted good faith negotiations leading to an increase in the offer, should have permitted the *Breswick* plaintiffs to offer evidence to support their claim that the increase was not substantial in relation to the total value of all the *Breswick* claims (which did *not* include any claim based on the 1949-50 exchange) and remitted the matter to the Special Master for further hearings (Ex. 27, R. 873).

### (b) *The negotiation of Kirby's "separate settlement":*

After Judge Dimock's decision of September 22, 1959, Kirby, in order to try to bring the lengthy and expensive litigations to a close, authorized Charles T. Ireland, Jr.

to explore through Phillips the possibility of a settlement of the litigation (R. 359). Until the litigation was concluded, the normal business activities of Alleghany would continue to be disrupted by the constant demands made on the time and energy of Alleghany's officers and on the financial resources of Alleghany itself (Ex. K-138, R. 1719).*

When Daly advised that neither the Young Estate nor the Murchisons were willing to contribute more to the Basic Settlement, Ireland turned to the possibility of what the complaint points out was a "separate settlement" for Kirby (R. 370-71). At this point Daly stated that his firm's representation of the Young Estate, which was against contributing more, prevented him from representing Kirby in a separate settlement based on an increase in the cash amount of the Basic Settlement (R. 2308).

On December 18, 1959, Donovan Leisure Newton & Irvine was substituted for Lord, Day & Lord as counsel for Kirby (R. 513-15). At the same time Ireland was substituted for Lord, Day & Lord as counsel of record for Alleghany both in *Breswick* and *Zenn*. Negotiations between David Teitelbaum of Donovan Leisure Newton & Irvine, as counsel for Kirby, and Graubard and Brussel,

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* At the trial below, Ireland described his feelings about the settlement, as an officer of Alleghany, as follows:

"A. Well, if you want to use as the factual standard the thought that for approximately five years Alleghany had not been able to conduct any of its business, actually what it had been for five years was sort of a retainership for law firms, it had practically no chance to move forward whatsoever, and here came a settlement which, among other things, produced three million dollars into the treasury of Alleghany, returned control of IDS from the Murchison brothers, to whom it probably never should have gone in the first place, back to Alleghany, and perhaps more importantly than all of these things it allowed or at least it would have allowed, if subsequent events had not come along, it allowed Alleghany once more to have the opportunity of becoming a living, breathing corporation. And that is what I mean, Mr. Carter, when I say the settlement was magnificent." (R. 380-81)

representing the *Zenn* objectant and the *Breswick* plaintiffs, respectively, were conducted on December 19 and 20, 1959 (R. 2309).

Ultimately, a separate Supplemental Stipulation of Settlement in the *Zenn* action was executed by Teitelbaum as attorney-in-fact for Kirby and by Graubard for the objectant Rosen in *Zenn* (Ex. 29, R. 887). It provided for the immediate payment by Kirby of $1,100,000, and for the payment of an additional $150,000 in lieu of Kirby's obligation under the Basic Settlement if the Basic Settlement ultimately should not be consummated (Ex. 7, R. 755). By the terms of this Supplemental Stipulation of Settlement and of the order of the New York court approving it, the *Zenn* action was to be severed and dismissed on the merits as to Kirby, while reserving all rights of Alleghany against the Young Estate, the Murchisons, et al. (Ex. 7, R. 750, 755). It further provided that in the event a judgment were later to be recovered against the other *Zenn* defendants, the amount of any such judgment was to be reduced by the pro rata share of Kirby's liability for his own part in the causes of action asserted (R. 750-51, 755-56).

**(c) *The hearing before Judge Dimock:***

An order vacating the *Breswick* injunction as to Kirby, consented to by Brussel on behalf of the *Breswick* plaintiffs, was prepared. Pursuant to arrangements made with the court by Brussel and Teitelbaum, the consent order was presented to Judge Dimock on December 22, 1959 (Ex. 30A, R. 889). Judge Dimock directed, however, that notice of the application be given to the other parties (Ex. 30A, R. 904, 906).

The following day, the Murchisons' attorney appeared and vigorously opposed Kirby's application; the Young Estate also declined to join in the Kirby settlement (Ex.

30B, R. 913, 916). But finally, unwilling to be left out, the Young Estate and the Murchisons reported to the court on December 24 that they had agreed upon settlement of their liability (Ex. 30C, R. 932-33). Daly advised Judge Dimock that the Young Estate had agreed with Graubard to contribute an additional $900,000 to the Basic Settlement in *Zenn* (Ex. 31, R. 938) and Judge Dimock thereupon signed the consent order dissolving the *Breswick* injunction.

**(d) *The separate Kirby Judgment:***

On December 28, 1959, Justice McGivern in the New York Supreme Court approved the Kirby Supplemental Stipulation of Settlement and entered an order directing that upon Kirby's payment of the amounts agreed upon "a judgment be entered herein severing and continuing this action as to all defendants other than Kirby, dismissing on the merits and with prejudice the consolidated amended complaint herein as to the defendant Allan P. Kirby but reserving all rights of Alleghany Corporation and its stockholders . . . . against all other defendants named herein. . . ." (Ex. 7, R. 750).

Thereafter, on December 29, 1959 Justice McGivern approved and made a similar order concerning a Second Supplemental Stipulation of Settlement presented to him on behalf of the Young Estate and the Murchisons (Ex. 9, R. 762-765).

On February 4, 1960, there was entered a judgment finally dismissing the *Zenn* complaint on the merits as to Kirby, upon proof of Kirby's performance of his obligations under his Supplemental Stipulation of Settlement (Ex. 11, R. 772-775).

Separate orders of dismissal on the merits were thereafter entered as to the Young and Murchison defendants,

and after all defendants had performed all their obligations under the settlement, a general release from all claims asserted in *Zenn* was delivered by Alleghany to each of ten defendants in the *Zenn* action (Ex. I-42, R. 2279-82).

On June 21, 1960, a final judgment dismissing the action on the merits as to all persons named as defendants in *Zenn* was duly entered (Ex. I-42, R. 2273, 2282-83).

## XIII. The Issues Presented and Tried Before the District Court in the Present Action:

The *Murchison* complaint made the "separate Kirby settlement" the subject of collateral attack in this action. The crucial paragraphs of the Supplemental and Amended Complaint, paragraphs 38 and 39, are precise in describing the boundaries and personal nature of Kirby's alleged fraud in terms of Kirby's knowledge, Kirby's actions, and Kirby's omissions:

> "38. By reason of *Kirby's* relationship to Alleghany as director, officer and controlling shareholder who had acquired Alleghany property in a transaction with Alleghany, and by reason of *his* position as a proponent of the settlement aforesaid, *Kirby was, under duties to disclose* or cause to be disclosed to the Referee, to the Special Master, to this Court and to the New York Supreme Court, all facts concerning the 1950 Exchange Transaction material to a determination by said official and said courts of Kirby's liability to Alleghany on the 1950 Exchange Transaction and the fairness and adequacy of the proposed settlement with respect to said liability.
>
> "39. *Kirby failed* to discharge the duties heretofore alleged in paragraph 38 by failing *to adduce*

> *or cause to be adduced* before the Referee, Special Master, this Court or the New York Supreme Court (a) *facts which* at the time of the 1950 Exchange Transaction *he knew or should have known* concerning the financial condition, future earnings and prospects of IDS and the ability of IDS to meet its contractual requirements. * * *" (R. 174-75, emphasis added.)

Kirby's Answer pointed out that in focusing on Kirby's "separate settlement," the complaint had omitted any mention of the other *Zenn* defendants, Young, Purcell, et al indispensable parties if the relief sought were to be granted (Fourth Affirmative Defense, R. 206).

Nevertheless, the District Court allowed the amended complaint to be filed, attacking only Kirby's conduct and Kirby's "separate settlement." The District Court and the parties agreed that the legality or propriety of the 1949-50 exchange was not an issue to be tried (R. 165). On December 14, 1962 the District Court, referring to the impending trial, stated:

> "It will not go into the issue as to whether the 1950 transaction was a bad transaction or not; it will go into the question of whether certain facts were concealed from the Court. Is that understood by everybody?"

The answer of Mr. Updike, petitioners' counsel, to this question was an unequivocal "Yes" (R. 165).

**(a) *Pre-Trial Development of the Issues:***

The District Court, adopting the "Plaintiff's Proposed Statement of Issues" (R. 336) after a "number of pretrial conferences . . . to define the issues in the action (R. 2289) defined the issue to be tried as follows:

"1. Did *Kirby procure by fraud* an order of this Court dated December 24, 1959,* vacating *insofar as Kirby was concerned,* an order of this Court dated October 27, 1955; an order of the New York County Supreme Court dated December 28, 1959;** a judgment of the New York County Supreme Court dated February 4, 1960;*** and releases from plaintiff subsequent thereto by means of:

* * * * *

"(b) *A failure by Kirby* to adduce or cause to be adduced before the State Court or its Referee or this Court or its Special Master in the *Zenn* (State) and *Breswick* litigations facts material to an *evaluation of Kirby's liability* on claims arising out of the 1950 Exchange Transaction and the fairness and adequacy of *Kirby's proposed settlement* in connection therewith?" (R. 336) (Emphasis added.)

Petitioners' counsel conceded at pre-trial that the plaintiff had the burden of proving fraud by Kirby personally. For instance, during the course of a pre-trial conference on March 25, 1963, in defining the issues to be tried, petitioners' counsel took this position:

"We would have the burden of convincing Your Honor on that phase of it [the charge of "non-

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* Order by Judge Dimock vacating as to Kirby the Injunction Order of Judge Walsh dated October 27, 1955 in *Breswick & Co.* v. *Briggs;* S.D.N.Y. Civ. Action No. 98-371 (Ex. 31, R. 938).

** Order by Justice McGivern dated December 28, 1959, approving supplemental stipulations of settlement with Allan P. Kirby, *Zenn, et al.* v. *Anzalone, et al.,* Sup. Ct. N. Y. Co., Index No. 7244/1954 (Ex. 7, R. 748).

*** Judgment of dismissal as to Defendant Allan P. Kirby, filed February 4, 1960, *Zenn, et al.* v. *Anzalone, et al.,* Sup. Ct. N. Y. Co., Index No. 7244/1954 (Ex. 11, R. 773).

> adduction" of documents] that there was a breach in duty *on Mr. Kirby's part* in *his* failure to adduce." (R. 234) (Emphasis added)

The limitation of the issue to Kirby's conduct was later noted by the Court of Appeals as follows:

> "This appeal is further limited to the claim that the settlement was obtained by defendant (appellee) Allan P. Kirby, as a result of *his failure* voluntarily to disclose upon the settlement certain facts, essential to a proper adjudication of the fairness and adequacy thereof, *alleged to have been known to him* at that time. The district court found adversely to appellant." (R. 2330)

With the issue thus carefully defined in the pleadings and pre-trial order, and the case prepared on this issue,* it was tried before the District Court (Hon. Archie O. Dawson) for three weeks from April 1-19, 1963 (R. 2292). Sixteen witnesses, including Kirby, Purcell, Ireland, and the persons who had been the principal legal counsel in *Zenn* (Graubard, Pomerantz and Daly) testified at length (the transcript exceeds 2,400 pages) and more than 220 exhibits were introduced (R. 2292).

Plaintiff had listed 86 documents as containing facts or circumstances within the scope of paragraph 39 of the complaint which in its view Kirby should have adduced before the Referee in *Zenn* (R. 222, 262-72; discussed at R. 232-34, 245-49, 255-56). "Plaintiff cannot state," it replied to Interrogatory No. 5, "whether the documents were seen or made available to" the objecting parties in *Zenn* and their counsel or to the Referee (R. 288-89). (As the case

* The pre-trial phases of the case were marked by extensive interrogatories, lengthy discovery proceedings at IDS in Minneapolis, and over 20,000 pages of deposition testimony from 25 witnesses, including an exhaustive examination of Allan P. Kirby (R. 318-30, 2288).

developed, the list of 86 dwindled to 30, and later, in response to questions from Judge Dawson and other judges, to 23, to 12, or even to two or three (R. 2348). For the most part, the so-called "non-adduced" documents consisted of financial statements, managerial working papers and memoranda, reports and forecasts obtained from the files of IDS and Alleghany, as distinguished from Kirby's files. Many, it turned out, were already in the *Zenn* record (R. 436). As to some, plaintiff's counsel conceded that there was no proof of knowledge or possession on Kirby's part (R. 574, 694, 2335, 2346). As to others, Mr. Kirby testified that he did not recall ever having seen them or having known of their contents (e.g., R. 450). The trial judge admitted documents from Alleghany's files, on the theory that as an officer, Kirby could have obtained them (R. 563). He refused to admit documents found in IDS' files, as to which the contrary was clear (R. 677).*

**XIV. The Findings and Conclusions of the District Court:**

The District Court, on the issues as tendered and tried, concluded that the "plaintiff completely and utterly failed to establish the causes of action which it has asserted" (R. 2327, bot.) finding that:

> (a) "plaintiff has failed to establish that defendant Kirby committed a fraud upon the State Court or its Referee in failing to produce documents at the hearings before the Referee which were not called for at the hearings and most of which were

* A detailed analysis of the evidence with respect to these documents is set forth below in Point I of our Argument (pp. 84-93, *infra*) insofar as they relate to Kirby, and in Point IV (pp. 125-37, *infra*) insofar as the same claim was later made with respect to Young and Purcell.

not in his possession but in the possession of IDS." (R. 2325)

(b) The documents which plaintiff claimed Kirby should have adduced were documents "[m]ost of [which] were produced from the files of IDS" (R. 2324) and "were documents found in the course of discovery proceedings in *this* action" (R. 2319) (Emphasis supplied by court).

(c) "The objectants to the settlement had a full opportunity to demand and require any papers which they thought material in connection with this hearing" (R. 2318-19), and "they took this obligation seriously" (R. 2319). They had the full discovery proceedings of the State Court at their disposal in establishing their position (R. 2319).

(d) The objectants "served a subpoena duces tecum on Alleghany Corporation in response to which more than 28 files of that corporation were produced which Graubard, counsel for the objectant Rosen, and his staff examined for over 64 man-hours. Graubard was satisfied that Alleghany had produced everything in its files called for by the subpoena." (R. 2319)

(e) "Robert R. Young's files relating to IDS were also produced and similarly examined. He testified at length before the Referee with respect to the 1950 Exchange Transaction. Robert Purcell, a director of IDS from the time of its acquisition by Alleghany in 1949 and a former President and then Chairman of the Board of IDS, responding to a subpoena duces tecum served by Graubard, produced a large number of documents. He also testified at length." (R. 2319)

(f) The testimony given in this case establishes that "the fact that there were such projections was well known to the attorneys in the *Zenn* settlement hearings" (R. 2324).

(g) The evidence which plaintiff claimed should have been adduced, when considered together with the evidence which was in fact adduced before the Referee, was not "of such significance that it would have caused the Referee to reach a different conclusion" (R. 2325).

The District Court further concluded that as a matter of law the action must be dismissed for the reasons that "A federal court sitting in a diversity of citizenship case is obligated to adhere to state substantive law" (R. 2321) and under New York law the failure to produce documents or to testify would not constitute extrinsic fraud permitting a federal court collaterally to attack a New York judgment (R. 2323). The District Court concluded that like newly discovered evidence, such failure to produce "may be the basis for seeking a new trial before the court that rendered the *Zenn* judgment, but is not a basis for collaterally attacking a judgment rendered after trial" (R. 2325).

**XV. The Decision of the Court of Appeals:**

On appeal, plaintiff for the first time advanced the claim that Young and Purcell withheld documents for which Kirby should be held responsible, and asserted as error

(a) the District Court's rejection of evidence as to which plaintiff was unable to show knowledge by Kirby;

(b) the District Court's rejection of plaintiff's legal theory that during the *Zenn* hearings Kirby had had an affirmative duty to ferret out documents which might have aided the objectants in their opposition to the settlement, even though he did not have possession, control, or knowledge of their existence;

(c) the District Court's finding that the additional evidence which plaintiff claimed Kirby should have ferreted out was merely cumulative of the evidence which had been introduced and would not have caused the *Zenn* Referee or the Supreme Court to have reached a different result;

(d) the District Court's conclusion of law that a judgment of a New York court may not be vacated by another court in the absence of proof of actual fraud in a matter extrinsic to the litigation, and that a failure to volunteer evidence would not constitute such fraud.

**(a) *The majority opinion:***

The majority opinion by Judge Moore found that:

(a) "In the light of the concession by plaintiff's counsel that he could not tie the financial projections sought to be introduced to Kirby's personal knowledge, the district court's refusal to speculate or infer that Kirby must have seen them cannot be characterized as 'clearly erroneous'" (R. 2346).

(b) There was no merit to appellant's "legal proposition that Kirby was under an affirmative duty to present facts which might aid his adversaries in establishing his liability" (R. 2343).

(c) The evidence which appellant claimed Kirby failed to adduce or cause to be adduced before the Referee in *Zenn* was merely cumulative of the evidence which was introduced. "By *a fortiori* analogy, the evidence said to have been 'non-disclosed' or concealed should at least be of the character required for a new trial, namely, would it 'probably have produced a different result'" (R. 2342).

In the light of these conclusions the majority opinion found it unnecessary to express any opinion as to the

District Court's holding with respect to the New York "extrinsic fraud" rule (R. 2346-47).

Although (in accordance with the District Court's express pre-trial directions, pp. 52-55, *supra*) the legality of the 1949-50 exchange had neither been presented nor tried as an issue in the case, and Kirby had therefore refrained from offering evidence as to the propriety of that transaction, Judge Moore expressed the view that for purposes of considering the appeal "There can be no question that the exchange . . . violated fundamental legal principles against self-dealing" and that the proxy statement used in connection with it "was misleading, both in its statements and particularly in its omissions" (R. 2341). Since these matters had been expressly excluded as issues below, the court's statement could have represented only an assumption, or obiter dictum, made for the purpose of considering the questions that were before it in a light most favorable to the appellants.

**(b) *The concurring opinion:***

Judge Kaufman declared in his concurring opinion that since the additional evidence which plaintiff sought to offer was cumulative and would not have altered the result in the *Zenn* action, it was unnecessary for him, in view of the adversary nature of the *Zenn* proceedings, to express an opinion with respect to whether a defendant in a derivative action had any greater duty to come forward with evidence than any other litigant (R. 2347). The concurring opinion further held as to the claimed non-disclosure by Young and Purcell, upon which the dissenting judge based his opinion, that he was "unable to agree that the conduct of Purcell and Young was such as to warrant overturning the judgment as against Kirby" (R. 2348).

**(c) *The dissenting opinion:***

The dissenting opinion concurred with the other opinions insofar as plaintiff's claim of fraud on the part of Kirby was concerned and stated that:

> "[I]nsofar as the plaintiff's case here hinged upon establishing personal dereliction by Kirby with respect to the settlement hearings, this was not made out." (R. 2351)

All three members of the appeal panel of the Court of Appeals also concurred in the District Court's rejection of plaintiff's legal thesis with respect to Kirby's burden of proof in *Zenn*. The dissenting opinion stated:

> "I agree nevertheless that a director thus sued is not bound actively to ferret out information that will promote the case against him or show the improvidence of a settlement to which he has persuaded a stockholder's lawyer to agree. . . ." (R. 2351)

The dissent went on to state, however, as the basis for its dissent:

> "But although the trial was largely conducted on one or the other of these theories, the complaint did not so limit the plaintiff, and on at least one occasion its counsel articulated another course which, in my view, it was entitled to pursue and which might well lead it to victory.
>
> "In examining Purcell and seeking to obtain admission of the evidence discussed below, counsel argued that 'if Mr. Kirby entrusts the responsibility to some extent of his being a director of Alleghany if he entrusts some of that responsibility to Mr.

> Young, then Mr. Kirby cannot avoid accepting the consequences of whatever Mr. Young may have done. . . .'" (R. 2351).

The dissent omitted, however, the balance of the statement by petitioners' counsel:

> ". . . and I do not say that it was Mr. Young and I do not say for a moment that it was Mr. Purcell, and I do not know who was responsible." (R. 606)

This disclaimer by petitioners' counsel is especially significant because it was made during the examination of Purcell, one of the two men charged for the first time on appeal with deceit and deliberate suppression of evidence.

Pursuing his theory of vicarious liability, the dissenting judge expressed the view that there was basis in the record from which to infer that certain documents (Exhibits 362 id. through 366 id.) which were known to Purcell and Young in 1954, had been knowingly withheld from the Referee by Young and Purcell; that since the introduction of such documents during the *Zenn* hearings might have produced a different result their exclusion in this case was error. On such basis he would remand the case for further trial on the new theory of alleged fraud by Young and Purcell (R. 2369).

### XVI. The En Banc Decision of The Court of Appeals:

The Court of Appeals, sitting en banc, affirmed the decision of its panel on January 12, 1965, by a vote of four-to-four. It took cognizance in a footnote of the only federal question which had been raised by the appellant, stating that:

> "In its reply on rehearing *in banc* appellant points out for the first time that since the claim in the state court suit relating to the exchange of

stock was grounded in part on an allegedly false and misleading proxy statement, see §14(a) of the Securities Exchange Act of 1934, 15 U.S.C. §78n(a) and SEC Rule X-14A-9, federal jurisdiction existed, see *J. I. Case Co.* v. *Borak*, 377 U. S. 426 (1964), and argues that §27 of the 1934 Act, 15 U.S.C. §78aa, made such jurisdiction exclusive and rendered the state court judgment void. We find it unnecessary to rule on the argument. For, apart from any other factors, the issue of jurisdiction was raised in and decided by the New York courts, 1 App. Div. 2d 662, 146 N.Y.S. 2d 286 (1955), motions for reargument and for leave to appeal to the Court of Appeals denied, 1 App. Div. 2d 773, 149 N.Y.S. 2d 86 (1956); and no attempt to secure review by the Supreme Court of the United States was made. See *Treinies* v. *Sunshine Mining Co.*, 308 U. S. 66, 78 (1939). On this the court is unanimous." (R. 2376)

## Summary of Argument

Two facts—not unrelated—tincture the whole of this case. It is a skirmish in a corporate war between the Murchisons and Kirby. And the stock of IDS has risen steadily since 1952 to a very high figure.

The influence of the hostility between the Murchisons and Kirby is manifest in the Murchisons' decision to bring this suit as a collateral attack on *Zenn* in the federal court, rather than move to reopen in the New York court. The course they chose bristled with obstacles—res judicata, full faith and credit, *Erie R. R.* v. *Tompkins*, extrinsic fraud, and others as well. The course they rejected would have been far more appropriate and adequate. But in the New York courts, which has continuing jurisdiction over *all* the parties to its prior judgment (Ex. I-42, R. 2283), the Murchisons could not have limited their fire to a charge of fraud by Kirby alone.

Under the impact of financial hindsight, two Court of Appeals judges below commented *obiter* on the legality of the IDS exchange transaction of 1949-50 (R. 2341, 2351). That question is not an issue in this proceeding (See pp. 51-55, *supra*).

Without these twin forces, the case would present only the status of concurrent findings of fact below, which petitioners do not challenge.

In 1959, Kirby took the initiative in settling *Zenn*, undertaking separate negotiations through separate counsel, and reaching a separate agreement against the wishes of his co-defendants (R. 359, 370-71; Ex. 7, R. 750, 755; Ex. 30B, R. 913, 916), the Murchisons and the Young Estate, who later settled, the Murchisons agreeing to return to Alleghany the control of IDS they had received from Alleghany in 1954, in one of the transactions attacked in *Zenn*.

This led to the present suit, a few months after the judgment in *Zenn*, as the opening round of the Murchisons' proxy contest to oust Kirby from control of Alleghany.

*Murchison* seeks to set aside the *Zenn* judgment only as to Kirby's separate settlement, and then only as to the one cause of action in which the Murchisons were not named as co-defendants. That cause of action concerned an exchange in 1949-50 of Alleghany preferred stock owned by Kirby and Young for IDS stock owned by Alleghany, and charged that Kirby and Young entered into the transaction in reliance on undisclosed inside information about the favorable prospects of IDS.

The case now presented by petitioners is not the case tried in the District Court. The issue presented and tried in the District Court was whether Kirby defrauded the *Zenn* court by "concealing" or not "adducing" material documents he was under a duty to proffer as to the fairness of his separate *Zenn* settlement (R. 336, 344. Having

failed on the trial and the appeal of that issue, petitioners now grasp at a suggestion in Judge Friendly's dissent, made for the first time on appeal, to the effect that the case might be reopened on the theory that Young and Purcell committed fraud for which Kirby, although admittedly innocent, might be held responsible (R. 2351). The dissent sought retroactively to inject such a theory into the trial below by bob-tailing a statement made by petitioners' counsel, during his examination of Purcell, in such a way as to give the impression that he was claiming liability based on the conduct of Young and Purcell (R. 2351), whereas the completed statement was a disclaimer of such a theory (R. 606). Throughout the trial, petitioners' counsel took the view that such a charge was incompatible with the complaint and statement of issues he had drafted (R. 234; see p. 96, *infra*).

Under either theory the questions raised by this appeal would be reached only if this Court should be willing to override as "clearly erroneous" under Rule 52, Fed. R. Civ. P., concurrent and unchallenged findings of fact of the two lower courts. Under the theory on which the case was tried, the issue of fact was whether the plaintiff could prove the existence of any significant facts about the financial prospects of IDS which Kirby knew or should have known in 1949-50, and which he concealed from or failed to volunteer to the New York court in *Zenn* (R. 174-75). Both courts below found that there was no fraud or wrongful failure to adduce evidence on Kirby's part.

Under the theory suggested for the first time on appeal, the issue of fact now is whether petitioners have shown any material evidence connected with Young or Purcell. Here again both courts below found that the documents upon which petitioners rely, taken all together, "were not of

such significance that they would warrant the Court upsetting the decision of the State court in any event."

These unchallenged findings destroy the factual predicate of petitioners' appeal. Without a showing of evidence not already in substance before the court in *Zenn*, there is nothing here to which their legal theories can be applied.

The main difference between *Zenn* and *Murchison* is that petitioners' counsel has come up with 12 documents which counsel in *Zenn* either missed; or, more probably, decided not to use (Point IV, pp. 125-36, *infra*). These documents are detailed managerial memoranda of various kinds, particularly income projections routinely prepared by IDS (See pp. 129,36, *infra*) of which Kirby was never an officer or director. They are the factual base of petitioners' case here. Petitioners now claim alternatively (1) that Kirby "concealed" these documents, although there is no claim that he ever saw or could have seen most of them (Point I, pp. 84-93 *infra*); (2) that he should be held liable for their alleged concealment by Young and Purcell, even though that claim was never alleged or tried below (Points II and III, pp. 94-110, *infra*); (3) that he should have searched them out and offered them in evidence in *Zenn*, even though they were made available to adverse counsel who did not do so (Point IV, pp. 113-22, *infra*).

From the existence of these documents they argue that the Court in *Zenn* was deprived of the possibility of exercising its judicial discretion as to the issue before it—the fairness, reasonableness and adequacy of Kirby's separate settlement in *Zenn*.

The courts below gave a short answer to this contention. The 12 documents, they found, were at most cumulative of evidence already before the Referee in

*Zenn*. In view of that finding, the entire edifice of inference spun from the existence of the 12 documents collapses (R. 2324-25; 2342).

So far as Kirby is concerned (Point I, pp. 84-92, *infra*), Kirby was shown to have had possession of only two of petitioners' 12 documents (p. 84, *infra*). Both were cumulative (pp. 86-90, *infra*). Five were at IDS (of which Kirby was neither an officer nor a director) in Minneapolis under the control of the Murchisons (p. 84, *infra*). The record does not show any failure on Kirby's part to adduce much less fraudulent concealment of, any material or significant evidence not already in substance before the New York court in *Zenn*.

For the first time on appeal, petitioners' counsel claimed fraud by Young and Purcell as a ground for setting aside the separate settlement of *Zenn* by Kirby. The rule against raising new issues on appeal applies here, where the issue sought to be presented, a serious claim of fraud, necessarily involves issues of fact never tried. Kirby, unanimously acknowledged to be innocent of fraud, had a right, in reliance on the *Zenn* judgment, to abandon the marshalling of evidence in defense of the legality of the 1949-50 exchange. It would be unjust to force Kirby now to attempt to resurrect proof ten years after the *Zenn* hearings were concluded, and six years after the entry of the *Zenn* judgment, because of a new claim of fraud on the part of Young and Purcell (Point II, pp. 98-99, *infra*; Point III, p. 100, *infra*).

There is, moreover, no showing of conspiracy or joint action between Young, Purcell and Kirby in the conduct of *Zenn*. (Point III, *infra*, pp. 102-04) The record is all to the contrary. It shows that Kirby acted independently in making his separate settlement of the Zenn action attacked here pp. 105-07, *infra*). Petitioners have proved no agency or co-fiduciary or conspiratorial

relationship between the three men, or any knowledge by Kirby of any wrongdoing by Young and Purcell such as might support application of the law as to the liabilities of co-conspirators or co-fiduciaries. The dissent below would infer a continuing conspiracy among Young, Purcell and Kirby on the assumption that the 1949-50 exchange was illegal—an issue not before the court. This is no more than adding inference to dictum. In any event, the theory of the dissent on this point is contradicted by facts of record (Point III, pp. 99-107, *infra*).

Since fraud on the part of Young and Purcell was neither alleged nor proved, the dissent was apparently unaware of clear proof in the *Zenn* record that Young and his counsel had made the Referee and all parties in the *Zenn* proceedings well aware of the existence of IDS earnings projections and their receipt by him at Alleghany, and that Young produced his personal files (Ex. 399, R. 1454) and more than 28 files of documents relating to IDS which were examined by counsel for the objectants in *Zenn* for four days (Ex. 399, R. 1451; Ex. K-355, R. 2077, 2080). Purcell appeared and produced all his IDS files and reports, which included IDS projections he had taken with him when he went from Alleghany to IDS (R. 580, 596-98, 600). Counsel for objectants examined the mass of IDS records produced by Purcell for only "a few minutes." (R. 1989) Although Purcell invited interrogation by *Zenn* counsel about these reports, counsel did not do so (R. 2055). Since some of the documents would have been harmful to the objectants' position, and at best cumulative, the strategy of their counsel is clear (pp. 131-33, *infra*).

Petitioners' case is based on passed-over and cumulative documents that furnish no support for their extravagant charges of conspiracy to defraud, nor, equally for the more limited claim that petitioners have produced evi-

dence Kirby ought to have sought out and offered to the Referee in *Zenn*. Since everything on which petitioners rely was found as a fact to have been before the court in *Zenn*, or clearly indicated to it, and since *Zenn* and *Murchison* are based on substantially the same allegations of fraud by the concealment of certain "inside information," *Zenn* must be treated in *Murchison* as res judicata not only on the jurisdiction of the New York court, but on the merits of *Murchisons* as well (Point IV, pp. 111-140, *infra*).

Petitioners' case claims "fraud," "deceit," "evasion," "dishonesty," etc. by Kirby and also by Young and Purcell in relation to *Zenn*. No new federal standard under the Securities Exchange Act is required to protect against such conduct. Adequate remedies under New York law are available to deter and punish fraudulent abuse of the courts' processes and to insure the production of evidence. New York law imposes high standards through pre-trial and other procedures that were extensively used in *Zenn*. The New York courts offer petitioners far more complete and adequate relief by way of a motion to set aside the *Zenn* judgment than a federal court may offer by way of collateral attack. The New York courts have the inherent power, now codified in C.P.L.R. 5015, to set aside or modify their own judgments for fraud, intrinsic or extrinsic. Such a motion would be referred to the *Zenn* judge (McGivern) who still functions and is best able to determine whether he was defrauded (Point V, pp. 141-151, *infra*).

For the foregoing reasons the controversial and doubtful questions of law raised by the Petition are not reached. If, however, this Court should overrule the unchallenged findings of the lower courts with regard to the case against Kirby, and the cumulativeness of the documents, two related questions of law would emerge:

(1) Was Kirby under a legal duty to search out and volunteer this material at the hearing before the Referee? and

(2) Would his breach of such a duty, if found, also constitute a fraud on the New York court justifying collateral attack in a federal court?

We deal with these questions in Points VI and VII of our argument (pp. 161-193, *infra*).

There is no substance in petitioners' claim that §14(a) of the Securities Exchange Act is the source of a new federal standard, defining the burden of enquiry and proof Kirby should have sustained in *Zenn*, and justifying collateral attack because of his failure to comply with such a standard.

The question was not raised below. And the possible bearing of the Securities Exchange Act on *Zenn* was decided twice by the New York courts which held that the *Zenn* action was rooted in common law, not §14(a). No appeal was taken to this Court.

But petitioners' contention has no merit for the additional reason that the general plan of federal securities legislation, unlike federal statutes in the field of patents, copyrights, antitrust or labor law, is that the requirements of federal law be superimposed on those of state law. Congress' purpose, expressed in §28 of the Securities Exchange Act, was that consistent state law shall remain in effect. Section 14(a) deals only with corporate voting. It does not, therefore, preempt or supersede, nor is it inconsistent with state law defining the fiduciary obligation of corporate directors, or state procedural law governing the conduct of stockholders' derivative suits. Nor, *a fortiori*, does it authorize a federal court to treat a state court final judgment as a nullity on the ground that the state judge misinterpreted the Securities Exchange Act in the course of the state proceedings.

Without legislation, §14(a) should not be interpreted as petitioners propose. The legislative history and administrative construction of the Securities Exchange Act negate petitioners' assertion. It finds no support either in case law, or in the dissent below, and raises constitutional and statutory doubts of the kind which it is the rule of this Court to avoid (Point VI).

If a federal standard for collateral attack on state court judgments for fraud cannot be drawn from the Securities Exchange Act, the question is necessarily one of New York law under *Erie R.R.* v. *Tompkins*. Under *Erie*, all questions concerning the delineation of rights are referred to the law governing substance—in this case, state law, as the court held in *Zenn*.

The two lower courts are agreed that the application of New York standards to the testimony and exhibits requires the conclusion that petitioners have failed to make their case against Kirby. Petitioners' counsel concede that counsel in *Zenn* may well have seen the documents they now say were "concealed" from that court by Kirby or in his behalf (R. 288-290).* They cannot therefore claim that these documents were *knowingly* withheld, nor indeed that they were not "adduced". Their claim is thus reduced on analysis to the proposition that Kirby's federally defined burden in state court litigation—a burden on which the very subject matter jurisdiction of the state court depended, according to petitioners—required him to search out and offer in evidence a dozen documents counsel in *Zenn* may have overlooked, or decided not to use.

Under New York law, and equally under the pre-*Erie* and post-*Erie* federal cases, petitioners have not made a case justifying collateral attack. We do not stress the supposed distinctions among the various competing rules

* See also R. 399, 600.

governing the availability of collateral attack. The failure of the petitioners' case is more fundamental, and it is a failure under any of the rules. Their action, undertaken as a tactic of corporate warfare, lacks equity and substance in every sense, and should be dismissed (Point VII, pp. 179 *et seq., infra*).

The present law (state and federal) imposes fiduciary obligations upon directors who are defendants in litigation. It requires them to be honest with the court and the parties and not to misrepresent or conceal any fact or document believed to be material.

The added duty proposed by petitioners would be contrary to the basic concepts of an adversary proceeding. Whatever duty may be appropriate in non-contested matters, the *Zenn* proceeding was sharply contested and fully adversary. The interest of the corporation was primarily represented by plaintiffs and their counsel. To require a defendant director to act at his peril in coming forward with whatever evidence *he* thinks an adversary might later deem relevant and material, would impose an impractical burden. The present record does not show the need for reform in existing statutory and judicial procedures for the conduct of stockholders' derivative actions in New York or elsewhere. It is wholly inadequate as a basis for the far-reaching rule proposed by petitioners. If such need can be shown, the problem is best dealt with by legislation (Point VIII).

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Respondent respectfully submits that the writ of certiorari should be dismissed as improvidently granted.

# ARGUMENT

## Introduction

This introduction deals with two preliminary questions which are crucial, we believe, to a realistic appraisal of the Murchisons' case: (a) their reasons for proceeding in the federal court rather than the state courts, and (b) the influence of the recent spectacular rise in value of IDS stock on the view of the case taken by some judges below.

The catalyst precipitating the present suit was a falling out between the Murchison brothers and the management of Alleghany, headed by Allan P. Kirby. The difference between them concerned the effective control of IDS.* The Murchisons had finally been forced to return IDS control to Alleghany through the settlement of *Zenn*, after Kirby began his separate negotiations for settlement, which at first they vigorously opposed. (pp. 47-50, *supra*). *Murchison* was filed on the same day the Murchisons launched a proxy fight to take control of Alleghany (and of IDS) from Kirby, with all the din and ritual of modern corporate warfare (R. 2288-89).

If the Murchisons seriously believed that Kirby had deceived the *Zenn* court by wrongfully concealing from it evidence of what he knew in 1949 and early 1950 about the financial prospects of IDS, the normal and natural procedure would have been to move in the New York Supreme Court to reopen its judgment in *Zenn*.** In

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* See R. 412-413. See, further, Lincoln, "Kirby's Fight to Hold Alleghany," 63 *Fortune* 120, 246-256 (April, 1961).

** Since the 1949-50 exchange was not involved in *Breswick*, and since the stockholders had chosen to proceed in the state rather than the federal courts with respect to *Zenn*, no basis existed for a similar motion in the district court under Rule 60(b) F.R.C.P.

such a proceeding, they would have faced none of the barriers and disadvantages of collateral attack by a federal court on a state court judgment—barriers inherent in any collateral attack and compounded here by considerations of comity in the relationship between state and federal courts.

The persons best able to decide whether they were defrauded by the "concealment" of evidence were the Referee (Hon. Robert J. Fitzsimmons) and the New York Supreme Court Justice (Hon. Owen McGivern) who had reviewed in detail the 4,600 pages of testimony by 18 witnesses and the 480 exhibits in *Zenn*, to which twenty-six attorneys addressed full briefs and extensive oral arguments over a period of many weeks (R. 1595; 1495-1590; 1717-20). Those experienced judicial officers were and still are the persons in the best position to determine whether the "non-disclosed" documents on which petitioners now rely "might have" or "would have" or "could have" affected their decision in *Zenn*.

These New York jurists are still in service. Under New York practice (C.P.L.R. 2221), such a motion would undoubtedly have been referred to them. New York law has at all times here involved given the New York Supreme Court full power to determine whether there was fraud in the procurement of the judgment in *Zenn*, and to set aside and modify the judgment "upon such terms as may be just" (C.P.L.R. 5015(a)*).

In such a proceeding under New York law, the New York Supreme Court may set aside or modify its own judgment for fraud, extrinsic or intrinsic; or because newly discovered evidence is offered; or for any other reason in the interests of substantial justice. *Crouse* v. *McVickar*,

* Reprinted in Appendix A, p. 4, *infra*.

207 N. Y. 213, 219 (1912). A motion before the New York court would have avoided the manifestly inequitable result sought in this collateral attack, namely, that the *Zenn* settlement be set aside as to Kirby alone, who was unanimously found innocent of fraud,* while continuing in effect as to Young and Purcell.

Such a New York motion is not barred by any statutory time limit.

But the adequate New York remedy was avoided by the Murchisons, since it would have risked reopening the judgment as to all *Zenn* defendants, including themselves, and would have made it impossible to concentrate their fire on Kirby alone. In the federal court, despite the hazards of full faith and credit, comity, and res judicata, the Murchisons could and did take the position that their case was exclusively against Kirby, that it related solely to Kirby's "separate settlement" in *Zenn*, and that it did not involve actions by Young, Purcell, the Murchisons themselves or others, or seek in any way to hold Kirby responsible for the acts or omissions of others. (See pp. 95-99 *infra*). Having failed to prove fraud on the part of Kirby, petitioners would now have this Court, sixteen years after the 1949-50 exchange, and almost six years after commencement of the present suit, remand the entire proceeding for another round to determine whether the federal court should set aside the New York judgment as to Kirby through evidence aimed at showing fraud by Young and Purcell, while at the same time preserving that judgment as to them.

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* R. 2325, 2346, 2347-2348, 2350, 2351.

What Judge Moore below called "the subconscious advantage of hindsight" (R. 2346)* has exerted an "hydraulic effect"** on the judicial process in this case. The spectacular increase in the market value of IDS stock since 1952 makes it difficult, even for men of experience, to resist the inference that something must have been amiss in a transaction between a corporation and its chief executive officers which turned out so well for its officers. The legality of that transaction—the IDS exchange of 1949-50—is not in issue here. This is a collateral attack for fraud alleged to have been committed in 1955 and 1956 upon the Zenn Referee, not an appeal from the order approving his Report.***

It has not been an easy matter to maintain the discipline of this distinction between the legality of the 1949-50 exchange at the heart of these tortuous proceedings—its legality, of course, as of the time it occurred—and the issue in this proceeding. Drawn on by the hydraulic pressure of hindsight, judges of the Court of Appeals who are normally exact craftsmen have been led to express themselves on the legality of the 1949-50 exchange, without benefit of a record of any trial of that issue, briefs or oral argument. (R. 2341, 2351, 2361-66.)

It is submitted, with deference, that their comments are unsupported dicta, which should be given no weight and no place in this appeal. Without the influence of such

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* See also, R. 2361.

** Northern Securities Co. *v.* United States, 193 U. S. 197, 400 (1904) (Holmes, J.).

***The Appellate Division dismissed two appeals from the orders and judgments of the Supreme Court of New York approving that Report. Zenn *v.* Anzalone, 10 App. Div. 2d 912 (1st Dep't 1960), 11 App. Div. 2d 748 (1st Dep't 1960). No effort was made to review these decisions in the Court of Appeals of New York or in this Court.

*a priori* opinions, however, it is hard to imagine that the courts would have had much difficulty in disposing of the only issues actually before them.

The only responsible judicial enquiry into the legality of the 1949-50 exchange was made by the New York Supreme Court in *Zenn*, as part of its consideration of the fairness and adequacy of the settlement. The Referee and the New York Supreme Court justice who tried *Zenn* were well aware that Alleghany's management had favorable IDS forecasts and income reports during the winter of 1949 and the early months of 1950 (Ex. 345, R. 1189; App. C, p. 43). The issue was highlighted by objectant Rosen, who pressed the claim that the concealment of favorable inside information of this type made the settlement unfair. (See pp. 43-44, *supra*.) The *Zenn* record reveals that Alleghany's management was equally aware, however, of the existence of unfavorable factors that might well have remitted IDS to its earlier condition of financial weakness (pp. 15-16, *supra*). They were aware, too, of the economic and financial conditions of the time, when sober opinion feared a renewal of the economic recession of 1948-1949, or worse. The outbreak of hostilities in Korea was still to come, with its far-reaching impact on the economy of the United States. Few people then anticipated the prolonged boom of the 'Fifties and 'Sixties, which drove up the volume of savings, and dramatically increased the profit levels and security prices of banks, insurance companies and mutual funds.*

* The rise in volume of IDS business, and therefore the value of IDS stock, should be viewed against the background of certain broad trends which have dominated the economy since 1949. It grew in surges, maintaining comparatively high levels of real growth, but also undergoing considerable price inflation. Rostow, Planning for Freedom (1959), pp. 330-357, esp. 336-345; Hickman, The Korean War and United States Economic Activity,

Considering the mass of proof before them as to the favorable and unfavorable factors influencing IDS' prospects in 1949 and 1950, the Referee and the New York Supreme Court refused to accept the contention that secret information enabled Kirby and Young to foresee the subsequent rise in IDS stock as a sure thing. In appraising the settlement, they realized that Kirby's and Young's business judgment, as is commonly the case, had to take account of real risks as well as real hopes, a process in which optimistic reports and forecasts were entitled to limited weight. They also had before them a great deal of other evidence of equal, if not greater, importance, which cannot be reviewed here, since the 1949-50 exchange is not in issue.

In Points I and IV of this argument (pp. 84-93; 125-37, *infra*) we shall examine the specific documents on which

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1950-1952 (1955), esp. pp. 17, 32, 46-51. The net result was a marked increase in dollar profits, in savings, and in the value of equities. These changes affected different companies differently, depending on the sector of the economy in which they operated, their management, and their capital structure.

The Dow-Jones composite average of 65 stocks rose from 71.9 (high) and 57.8 (low) in 1949 to 150.2 (high) and 106.0 (low) for 1954, and 269.1 (high) and 228.7 (low) in 1963. Standard & Poor's Trade and Securities Statistics, Security Price Index Record (1964 Ed.), p. 169. The market price of Xerox on Jan. 1, 1965, for instance, was 295 times, its market price, on Jan. 1, 1950.

The rise for financial institutions, spurred by the growth of savings, was higher. The annual average price of the 11 life insurance company stocks comprising the Standard & Poor Index was 19.61 for 1949, 86.67 for 1954, and 302 for 1963. *Id.* at 110. Encouraged by the protection of the Investment Company Act of 1940, investors turned to mutual funds on an extraordinary scale after the end of the war. The total net assets of Open-End Investment Companies rose from $1.97 billion (91 companies) in 1949 to $29.12 billion (159 companies) in 1964, or almost 15 times. Moody's Investors' Service, Bank and Finance Manual (April, 1965), pp. a 51. In this period the assets managed by IDS increased from $0.5 billion in 1949 to $5.6 billion in 1964.

petitioners rely to show what Kirby knew in 1949 and early 1950 about the future of IDS. At this stage, however, we call this Court's attention to four facts of record which simply and conclusively epitomize the view of IDS which serious financial opinion took at the time:

(1) the price which Gamble accepted for his stock a few months before the IDS Exchange, after several years of trying to sell it through the most perceptive and astute bankers of the nation (see p. 13 *supra*);

(2) the sale by Crabb, the President of IDS, on July 24, 1950 of a block of 3,034 shares of IDS at $20 per share, despite his intimate knowledge of the "crucial projections" which this Court is asked to believe are so material as to warrant reversal of the courts below (R. 1385);

(3) the slow and hesitant rise of IDS stock prices, during the early fifties, long after the financial world had thoroughly absorbed the optimistic news petitioners here ask this Court to believe was of such fundamental significance (See pp. 20-23 *supra*, and Appendix E); and

(4) most important of all, in 1954, under the direction of Young and Kirby, Alleghany sold the Murchisons its controlling interest in IDS, without any consciousness that its block of voting stock would become the Golden Apple of a corporate struggle which has already lasted longer than the Trojan War (R. 1655).

Thus it is apparent from the *Zenn* record that the view of the 1949-50 exchange taken by the Referee and the Court is at least as plausible as that expressed by some of the judges below.

We therefore respectfully urge this Court not to indulge in any assumption as to the legality of the 1949-50

exchange, an issue that has never been tried, and to direct its attention first to the only issue tried below, the question of whether Kirby defrauded the *Zenn* Referee and Court.

## POINT I

**The record and findings below are conclusive that there was no failure on Kirby's part in *Zenn* to adduce all material facts within his knowledge or possession. The questions raised by petitioners are therefore not reached.**

The first issue (and, we submit, the only issue) presented by the record in this case is whether the *unanimous* finding of both courts below that Kirby did not commit fraud on the New York Court in *Zenn* should be set aside as "clearly erroneous."* Rule 52(a) Fed. R. Civ. P. The sole claim, and the sole issue, presented at trial was whether there was any fraud, concealment, or withholding of material evidence on the part of Kirby, *not* of Young or Purcell. The pleadings, the conduct of the trial, and the record as a whole are consistent on the point. Fraud by Kirby was the only question of the case.

The record is conclusive. The findings below as to Kirby, far from being "clearly erroneous," were fully supported by credible proof. The record is equally clear that no breach of duty on Kirby's part has been shown even if this Court were to adopt petitioners' proposed rule to the effect that a director-defendant, in proceedings contesting the settlement of stockholders' claims against him, must search out and volunteer all material evidence which he might conceivably have found.

* See Pick Mfg. Co. *v.* G. M. Corp., 299 U. S. 3, 4 (1936).

The issue carefully presented by paragraphs 38 and 39 of the Amended and Supplemental Complaint to the District Court for trial was whether Kirby committed fraud. After 20,000 pages of pre-trial depositions and a series of pre-trial conferences in which the scope of this issue was thrashed out at length and clearly defined, the District Court adopted the plaintiff's statement of the issue tendered for trial as follows (R. 336, 344).

> 1. Did Kirby *procure by fraud* an order of this Court . . . and releases from plaintiff subsequent thereto by means of:
>
> . . . . .
>
> "(b) A failure by Kirby to adduce or cause to be adduced before the State Court or its Referee or this Court or its Special Master in the *Zenn* (State) and *Breswick* litigations facts material to an evaluation of Kirby's liability on claims arising out of the 1950 Exchange Transaction and the fairness and adequacy of Kirby's proposed settlement in connection therewith?" (Emphasis added).

Such a charge of "fraud", even when that term is used in its loosest sense, is a serious one. In this context it denotes at least some consciousness on the part of Kirby that he had failed to disclose material facts. Any suggestion that the petitioners claim no more than an unintentional or negligent failure to search out and volunteer evidence is dispelled by the charges, which permeate petitioners' brief, that Kirby was guilty of "deliberate deceit," "evasions," "concealments" and "dishonest" conduct before the *Zenn* court. (See, e.g., Pet. Br. p. 16, where petitioners state "Kirby successfully withheld the projections and the other damaging evidence"; and Pet. Br. p. 42 stating "There can be no doubt that Kirby knowingly joined with his co-fiduciaries in their fraud").

Normally, fraud is not presumed, but must be established by clear and convincing evidence. *United States* v. *Wunderlich,* 342 U. S. 98, 100 (1951); *Southern Dev. Co.* v. *Silva,* 125 U. S. 247, 249-50 (1888).*

Both at the trial and before the Court of Appeals, the fraud charge against Kirby was properly confined, as paragraph 39 of the complaint confines it, to the question of whether he concealed material facts about the financial condition, future earnings and prospects of IDS (i) which he knew or (ii) should have known as a director and officer of Alleghany, (iii) at the time of the 1949-50 exchange (R. 174-75).

The courts below were unanimous in the view that no such fraud on the part of Kirby had been established. The District Court concluded:

> "The Court concludes that plaintiff has failed to establish that defendant Kirby committed a fraud upon the State court or its Referee in failing to produce documents at the hearings before the Referee which were not called for at the hearings and most of which were not in his possession but were in the possession of IDS" (R. 2325).

There was no disagreement on the part of the Court of Appeals as to the facts found with respect to Kirby. Following the District Court, it posed the issue as follows:

> "This appeal is further limited to the claim that the settlement was obtained by defendant (appellee) Allan P. Kirby, as a result of his failure voluntarily

* *Accord:* Shahadi *v.* Commissioner of Internal Revenue, 266 F. 2d 495, 501 (3d Cir.), *cert. denied,* 361 U. S. 874 (1959); Commercial Credit Corp. *v.* Sorgel, 274 F. 2d 449, 453 (5th Cir.) *cert. denied,* 364 U. S. 834 (1960); Lackawanna Pants Mfg. Co. *v.* Wiseman, 133 F. 2d 482, 486 (6th Cir. 1943); Huszar *v.* Cincinnati Chem. Works, 172 F. 2d 6, 11 (6th Cir. 1949); Hablas *v.* Armour & Co., 270 F. 2d 71, 77 (8th Cir. 1959); State Farm Mut. Auto. Ins. Co. *v.* Petsch, 261 F. 2d 331, 334 (10th Cir. 1958); 9 Wigmore, Evidence §2498, p. 329 (3d ed. 1940).

> to disclose upon the settlement certain facts, essential to a proper adjudication of the fairness and adequacy thereof, alleged to have been known to him at that time. The district court found adversely to appellant." (R. 2330)

All judges agreed that no such non-adduction of evidence by Kirby had been shown. In affirming the findings of the District Court on the issue of Kirby's lack of possession or control of the documents, Judge Moore of the Court of Appeals pointed out that:

> "Essential to such resolution were such fact findings as Kirby's possession and control of the documents, his knowledge of their contents and his suppression thereof. Upon the trial, the counsel representing Alleghany had full opportunity to examine and cross-examine the principal alleged culprit, Kirby, Pomerantz (counsel for the stockholders in the *Zenn* suits), Graubard (counsel who so vigorously opposed the settlement), Purcell, Shipman, the various attorneys who were instrumental in bringing it to a conclusion in December, 1959, and other witnesses. After hearing these witnesses, the court found 'that plaintiff has failed to establish that defendant Kirby committed a fraud upon the State Court or its Referee in failing to produce documents at the hearings before the Referee which were not called for at the hearings and most of which were not in his possession but were in the possession of IDS.' 218 F. Supp. at 186. In the light of the concession by plaintiff's counsel that he could not tie the financial projections sought to be introduced to Kirby's personal knowledge, the district court's refusal to speculate or infer that Kirby must have seen them cannot be characterized as 'clearly erroneous.'" (R. 2346)*

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* Judge Kaufman, concurring on an even broader ground—the cumulativeness of *all* the evidence, including the portion never tied to Kirby—agreed that personal dereliction on Kirby's part was not established (R. 2347-48).

The Court of Appeals correctly declared that "in view of this factual finding" (R. 2346) the judgment of the District Court should be affirmed. Judge Friendly, while dissenting, concurred with the majority "that insofar as the plaintiff's case here hinged upon establishing personal dereliction by Kirby with respect to the settlement hearings, this was not made out" (R. 2351). His dissent was not based on the ground that Kirby had suppressed or failed to volunteer material evidence within his knowledge or possession, but on the assumption (the error of which is shown *infra*, p. 95) that petitioners' counsel had ventured to claim that Kirby could be held responsible for fraud on the part of Young and Purcell. In fact petitioners' counsel had disclaimed such a charge (pp. 95-96, *infra*).

During pre-trial, petitioners' counsel submitted to the trial court a list of 86 documents claimed to contain material information withheld by Kirby from the *Zenn* Referee (R. 262-72). As trial progressed these were whittled down to a group of 12 or fewer. The 12 documents, like trout in a creel, proved to be different and smaller on every inspection. Only 5 have survived from those discussed in plaintiff's post-trial brief under the heading "Material documents not adduced before the Referee" (plaintiff's post-trial br., pp. 124-26, 131). Petitioners' brief now classifies the "concealed" documents as follows:

| | Exhibit No. | Record Reference |
|---|---|---|
| "(1) The Waag Correspondence" (Pet. Br. pp. 9-11) | 362-66 id. | 1342-60 |
| "(2) The Projections and Actuarial Studies" (Pet. Br. pp. 11-12) | 220 | 1053 |
| | 243 | 1104 |
| | 244 | 1119 |
| | 245 id. | 1121 |
| | 246 id. | 1136 |
| "(3) The Stiver Reports" (Pet. Br. pp. 12-13) | 310 | 1157 |
| "(4) The Monthly Reports" (Pet. Br. pp. 13-14) | 242 | 1092 |

Petitioners' categories are misleading for the purpose of considering the charge against Kirby because they fail to advise the Court that Kirby had possession, during the hearings before the *Zenn* Referee held in 1955 and 1956, of only one of these documents, Ex. 310 (R. 1157), which was produced from his files in response to routine discovery in this action. A copy of one other document, Ex. 220 (R. 1053), the 1949 Froggatt Actuarial Report, had been in his office for a few weeks in 1949, but was returned in early September 1949. Neither, we show below, is significant as to the *Zenn* issues.

Petitioners also neglect to advise the Court that all of the projections now relied upon by them (e.g., Exs. 242, 243, 244, 245 *id.*, 246 *id.*) are IDS records, produced in this proceeding (again pursuant to pre-trial discovery) from the Minneapolis files of IDS, of which Kirby was never an officer, director or employee, but which was under the control of the Murchisons during the period when Kirby is alleged to have withheld them, *i.e.*, from early 1955 to April 1960 (Ex. 399, R. 1458-60).

We turn to a closer analysis of the four categories of documents now asserted by petitioners as the cornerstone of their charges of "Evasions and Deceits" against Kirby*:

**(1) "The Waag Correspondence"** (Pet. Br. pp. 9-11)**

Kirby was not a party to this correspondence, which took place between others (Waag, Purcell and Young) in July 1954, more than four years after the 1949-50 ex-

* Insofar as they pertain to Young and Purcell, these documents are discussed *infra*, pp. 125-36.

** Insofar as it relates to Young and Purcell, this correspondence is fully discussed *infra*, pp. 125-29.

change and he was unaware of its existence. On their face the enclosures could not have come into existence until after the 1949-50 exchange, since they give operating results for the full year 1950. One enclosure (Ex. 365 id., entitled "Investors Diversified Services, Inc. Comments on Operations December, 1950," R. 1347) is pointed to by Judge Friendly as a clue showing that IDS had made an optimistic forecast of its 1950 earnings. Since Kirby never had Ex. 365 id., he could not have supplied it to anyone as a "clue." The District Court excluded Ex. 365 id. "as not connected with Mr. Kirby" (R. 694). As to the projection whose existence Ex. 365 id. supposedly would have disclosed, petitioners' counsel conceded at trial "There is no proof that Mr. Kirby had it" (R. 574, 694).

This disposes of "the Waag Correspondence" insofar as the charge against Kirby is concerned.

**(2) "The Projections and Actuarial Studies"* (Pet. Br. pp. 11-12)**

Almost all the documents falling within this category were IDS records, produced from IDS' files in Minneapolis pursuant to pre-trial discovery procedures in this case. The documents were never shown to be within Kirby's knowledge, or possible knowledge or possession. As petitioners' counsel, using these IDS records, took Kirby through a document-by-document examination (R. 460-68, 473), his uncontradicted testimony convinced the trial judge that he did not have knowledge of their existence, much less their contents.** Aside from his lack of per-

* Insofar as they pertain to Young and Purcell these documents are discussed below at pp. 129-34.

** The only IDS document in this category shown to have been in Kirby's files proved to be immaterial on its face and petitioners do not mention it. This was an IDS Mortgage Projection (Ex. 351, R. 1207) sent to Kirby by Crabb by letter of May 22, 1950.

sonal knowledge of these documents, Kirby, being neither a director nor an officer of IDS, could not have "ferreted" them out during the *Zenn* settlement proceedings without use of the same legal process available to the objectants. On the other hand, Kirby's accusers, the Murchisons, being then IDS officers and directors in control of IDS, could have done so had they wished, through their counsel who was present at the *Zenn* hearings (R. 1458-60).

The only document in this category ("Projections and Actuarial Studies") connected in any way with Kirby was an Actuarial Report by Joseph Froggatt & Co., Inc., dated April 29, 1949 (Ex. 220, R. 1053). It was received by Kirby's office from Alleghany in August 1949, and returned to Alleghany on September 2, 1949 (Ex. 331, R. 1172). Kirby testified that he had no recollection of ever seeing it (R. 450) and, in view of its prompt return, he did not have it in his possession at the time of the *Zenn* hearings which took place in 1955, more than six years later.

This Frogatt report (Ex. 220), like other such Frogatt reports regarding IDS' ability to meet its certificate requirements, was made to the Board of Directors of IDS, of which Kirby was not a member. It discussed the valuation as at December 31, 1948, of the certificates in force of Investors Syndicate (as IDS was then called). It concluded that an earnings rate of 4.864% would be required on the dollar amount of reserves maintained by the Company at December 31, 1948 to meet its maturities and other contract requirements; that for the year 1948 the

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Testifying thirteen years later, Kirby stated that he did not have the "faintest idea" whether he had seen it earlier. Even if he had seen it, it was immaterial to the issue before the *Zenn* Referee (whether Kirby had "inside information" *at the time of the 1949-50 exchange*) because he could not have seen it until three weeks after that exchange was consummated and approved by Alleghany's stockholders.

earnings rate had been 4.916%; that for the past five years the earnings rate had averaged 4.560%; that a prognostication had been made for the five years 1949-1953 indicating a "possible" average earnings rate of 5.845%; and that "assuming the reasonableness of the prognostication," Investors Syndicate "should be able to meet contract requirements over a number of years," (Ex. 220, R. 1056, 1058).

That is all this report showed, with its supporting schedules. The supporting schedule "C" contained the prognostication of "net income (before profit or loss on sale of investments or income taxes)* available for improving installment certificate reserves". It showed a modest increase in this category of 1949 income over 1948 income, a further increase for 1950 and 1951, and then a drop in both 1952 and 1953 (R. 1059, 1060). This was scarcely a glowing report even as to this specially defined category of gross income.

The record before the Referee made repeated mention of the ability of IDS to meet its certificate requirements. There was no secret about Frogatt's actuarial reports. Each annual report of IDS noted them (Exs. K-358, R. 2125; K-359, R. 2148; K-361, R. 2171); and Shipman's report of August 15, 1949, identified the very report of April 29, 1949, and quoted its actuarial conclusions as to the sufficiency of IDS' reserves to meet its certificate maturities (Ex. K-295, R. 1958) to which petitioners draw attention.

Petitioners, furthermore, erroneously state that the Frogatt Report "revealed that IDS expected a steady increase in earnings and that by 1953, earnings would

* Income projections were routinely prepared by the IDS staff, and not, as Pet. Br. suggests, by Froggatt (R. 1055).

be nearly ten times those for 1948." (See Appendix B, Tabulation of Errata, pp. 29-30.) As the chief Frogatt actuary testified (R. 690-92), the Frogatt reports did not project future per share earnings of IDS, nor was there any way of determining such earnings from those reports. As the reports themselves specifically stated (R. 1059), they simply show projected IDS income "available for improving installment certificate reserves."

Thus the record of this case, and the testimony of Mr. Kirby, demonstrate that no matter what burden was imposed upon him, he did not withhold or conceal any material "Projections and Actuarial Studies" from the *Zenn* Referee.

**(3) The Stiver Reports (Pet. Br. pp. 12-13)**

Petitioners claim that one document, the second Stiver & Co. report of March 15, 1949 (Ex. 310, R. 1157), was "concealed." We submit that the record shows this charge to be frivolous. As to the report Kirby testified in this proceeding, "I don't remember ever seeing it before" (R. 438).

The document is alleged to be significant because it contains optimistic conclusions about IDS as an investment and recommends, more than a year prior to the 1949-50 exchange at issue before the *Zenn* Referee, that Alleghany purchase control. The *Zenn* record, however, reveals that the existence of the second Stiver report was well known to the *Zenn* Referee and to objectants' counsel, that it was discussed, named, incorporated by reference, updated and corrected in a report in evidence in *Zenn* which was made three weeks later by Alleghany's own securities analyst, Charles Shipman, and contained

the same optimistic conclusions and recommendations (Ex. K-294, R. 1933). There is not a single substantive aspect of the second Stiver report that is not covered, and covered in greater detail, in the more comprehensive Shipman report (K-137, R. 1634).

The Shipman Report before the Referee (Ex. K-294, R. 1933), after expressly referring three times to the second Stiver Report (R. 1938, top, 1944, bottom, 1947, bottom) took an unequivocally favorable view of Alleghany's proposed investment in IDS:*

> "The following conclusions seem justified by the foregoing analysis:
>
> "(1) The combined business represented by I.S. and its subsidiary and affiliated interests is on the whole, uniquely well conceived and solidly established;
>
> "(2) It is a 'safe' business, involving considerably less than the usual risk of financial misfortune;
>
> "(3) It is a growth business;
>
> "(4) It is a business which promises eventual rich profit rewards.
>
> "The terms under which we have been offered 85,660 shares of I.S. common (voting) stock are definitely attractive. It should be remembered that the terms do not call for an investment of $2,600,000 by us at the present time. (We could get the stock for a much smaller figure on the basis of a lump-sum payment.) The $2,600,000 figure is a conditional one, *depending on actual future earn-*

* Compare with the claim (Pet. Br. p. 15) that *Zenn* defendants "persistently cried down the prospects of IDS" and "concealed" the evidence of favorable prospects for IDS.

> *ings.* The down payment called for is only $1,300,000. If sufficient earnings are available to call for payment of an additional $1,300,000, such additional payment will have been amply justified. That the available earnings will be more than sufficient for this I have no doubt." K. 294 at 418a-419a.

The "concealed" Stiver Report is a public document, on file with the Securities Exchange Commission (Commission Ex. 23B *In the Matter of IDS,* S.E.C. Docket No. 812-596) Counsel for the stockholders in *Zenn* searched the files of the S.E.C. in preparing their case (Ex. K-355, R. 2091-2092).

At p. 12 of their brief, petitioners charge, with italics, that the absence of the second Stiver Report from the *Zenn* record was the result of "deliberate" concealment. In view of the fact the second Stiver report is referred to by name and date several times in the *Zenn* Record, and that it is on file at the SEC, petitioners' charge of "concealment" is baseless sham.

**(4) The Monthly Reports (Pet. Br. pp. 13-14)**

Petitioners indulge in misleading innuendo so far as Kirby is concerned when they assert that the *Zenn* "defendant-directors"* selected those of the IDS monthly reports they would produce and those they would withhold and that "Kirby .... had received these reports every month" (Pet. Br. p. 13). No record reference is given. The

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* The term "defendant-directors," of course, includes Mr. Kirby. Petitioners use this phrase (and the term "insiders") rather than refer expressly to Kirby on the theory that they can thus impute by indirection to Kirby actions and knowledge of facts which they know cannot be proved as to him.

record fails to show that Kirby ever actually received or had possession of more than a single one of the IDS "Monthly Reports" or "Summaries of Operations."*

Petitioners' theory that production of IDS Summaries of Operation in the *Zenn* proceedings "would have given away the fact that such projections existed and were regularly prepared at IDS" (Pet. Br. p. 13), is thus refuted by the *Zenn* record.

The *Zenn* Referee and counsel for the plaintiffs and for the objectants (R. 399) were aware that IDS regularly prepared and kept projections and forecasts with respect to its earnings, its ability to meet its certificate obligations, and its mortgage operations, including five-year projections (Ex. 356 A, R. 1220; App. C, p. 36). All of these, being regular routine IDS reports, could have been examined at its headquarters in Minneapolis** or produced in New York by the Murchisons, who were *Zenn* defendants, were represented by counsel at the *Zenn* hearings and controlled IDS and its files (R. 1458-60).

Young had testified on March 29, 1955, in a deposition in *Zenn* (federal), which was marked as Ex. 4 before the *Zenn* Referee, that IDS "kept projections of its matur-

* In response to pre-trial discovery proceedings in this action, Kirby produced the only such Summary in his files, which petitioners do not even mention. This was an IDS Summary of Operations for the year 1949, dated March 28, 1950 (Ex. 348, R. 1193). When asked if he could identify it, Kirby testified, "I have no recollection of it, but I would not deny that I may have glanced at it" (R. 457). If Kirby had glanced at it, he would have found operating results of IDS for 1949 and 1948 and for the months of December 1949 and December 1948, compared with past projections for 1949 and December 1949 (R. 1193-94). He would have found no projections of 1950 or of future earnings. In fact, Ex. 348 contains the same information with respect to actual earnings in the periods in question that was in the *Zenn* record (Ex. K-179, R. 1834).

** See p. 122, *infra*, for a discussion of Minnesota law, obligating its courts to enforce New York deposition orders.

ity obligations and the available funds with which to meet it"; that from time to time he had received IDS "projections" of funds available for the meeting of these certificate reserves; that he had also from time to time received IDS "earnings forecasts," which were "made currently, as part of the corporation's regular routine"; and that "once a year the company [IDS] would make a projection of its outlook over a period of five years."* Furthermore, the Purcell Report of February 11, 1950 to Young and Kirby (Ex. 345, R. 1189) refers to IDS Mortgage Department projections for 1950. Shipman's report of April 7, 1949 (Ex. K-294, R. 1945) contains an IDS ten-year projection of income submitted to the SEC. IDS Summaries of Operations were referred to by name in a letter from Waag to Purcell dated Aug. 2, 1955 (Ex. 354, R. 2060), which was *Zenn* Ex. 400.

Since petitioners' counsel did not, prior to their appeal herein, advance their theory that Kirby should have ferreted out "clues" as to the existence of projections, there was no occasion in the District Court for Kirby's counsel to marshall "clue" documents or testimony from the *Zenn* record. The *Zenn* record on file in the New York Supreme Court (*Zenn* v. *Anzalone*, Sup. Ct., New York Co., Index No. 7244/1954), does contain plenty of such "clues." For example, *Zenn* Ex. 356-TTT (reproduced here as Appendix D of this Brief), which was one of 96 docu-

* Since petitioners' counsel expressly limited plaintiffs' claim here to alleged fraud by Kirby, Young's deposition in Zenn (federal), which was a Zenn exhibit, was not introduced by either side at the trial here. The relevant pages are annexed hereto as Appendix C and may be judicially noticed by this Court. Cramer *v.* Washington, 168 U. S. 124, 129 (1897); National Fire Ins. Co. *v.* Thompson, 281 U. S. 331, 336 (1930); Alexander *v.* Hillman, 296 U. S. 222, 231n. (1935).

ments found by Graubard, counsel for the *Zenn* objectants in an Alleghany Corporation file (Ex. 399A, R. 1439, 1442), is a letter from Crabb, President of IDS, to the directors of IDS attaching a two-page comparison of actual IDS cash receipts and disbursements with estimated or projected figures for the period from January 1, 1950 through July 31, 1950. This document is more than a "clue" as to the existence of IDS projections or estimates. It states quite clearly, without need for inference, that:

> "Contractual receipt and disbursements estimates were made in December 1949 and based on data available as of September 30, 1949 and November 30, 1949. Estimated Mortgage Receipts for the Second Quarter were revised in March 1950 and for the Third Quarter in June 1950. The Mortgage Sales and Fundings estimates were made by the Mortgage Department at the beginning of each quarter."

Thus, the *Zenn* Referee and *Zenn* counsel did not need IDS Monthly Summaries of Operations, such as Ex. 242, as clues to lead them to IDS projections.

***Conclusion***

This is the record as to Kirby. It does not prove the existence of any material evidence about IDS' prospects in 1949-50, not already in substance before the *Zenn* court, which Kirby could possibly have concealed, suppressed, hidden or failed to volunteer in evidence. The findings of the District Court, affirmed by the Court of Appeals, are therefore correct and we respectfully urge that the Writ of Certiorari should be dismissed.

## POINT II

**Petitioners' Assertion of a New Claim Against Kirby Based on Alleged Fraud by Young and Purcell, which Was Neither Alleged Nor Tried Below, Is Precluded by the Rule Against Raising New Issues on Appeal and Violates Basic Principles of Procedural Fairness.**

The issue carefully framed five years ago and tried below was limited to the question of whether there was any fraud on Kirby's part in the *Zenn* proceedings. All courts below unanimously found that Kirby did not commit any such fraud.* Having failed to prove fraud by Kirby, counsel for petitioners, for the first time on appeal, claimed fraud by Young and Purcell as a basis for setting aside the approval of "the separate Kirby settlement" in *Zenn*.

Nowhere in the 64-paragraph supplemental and amended complaint or in the prayer for relief did plaintiff below claim fraud by Young or Purcell in the procurement of the *Zenn* judgment, or liability of Kirby predicated on fraud by Young or Purcell. (R. 166-89) No such issue was suggested by the pleadings, issues** and proof tendered to the District Court.*** On the contrary, it was expressly disclaimed by petitioners' counsel at trial (R. 606, see pp. 95-96, *infra*).

The majority opinion in the Court of Appeals specifically noted that the appeal to it was limited to Kirby's failure to disclose facts "known to him:"

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* R. 2325, 2346, 2347-48, 2351.

** Since the issue was limited by the District Court's pre-trial order (R. 336, 344) pursuant to a series of Rule 16 conferences and was never modified, it "controls the subsequent course of the action." Rule 16, Fed. R. Civ. P.

*** R. 174-75, 206, 209-10; plaintiff's post trial reply brief, p. 45; see p. 96, *infra*.

> "This appeal is further limited to the claim that the settlement was obtained by defendant (appellee) *Allan P. Kirby,* as a result of *his* failure voluntarily to disclose upon the settlement certain facts • • • *known to him* at that time." (R. 2330) (Emphasis supplied.)

The dissent, while agreeing that a case based on "establishing personal dereliction by Kirby . . . was not made out" (R. 2351), then made the crucial assumption that "the complaint did not so limit the plaintiff". (Ibid.) The dissenting judge did not, however, point to any paragraph of the complaint in support of his statement. There is none.*

The only support offered by the dissent for this theory was a statement of petitioners' counsel during his examination of Purcell before the District Court (R. 606), which the dissent truncated in such a way as to make it state the opposite of what the record shows to have been said (R. 2351). The actual statement of petitioners' counsel (at R. 606) was

> "Mr. Updike: Well, it seems to me, sir, that if Mr. Kirby entrusts the responsibility to some extent of his being a director of Alleghany, if he entrusts some of that responsibility to Mr. Young, then Mr. Kirby cannot avoid accepting the consequences of whatever Mr. Young may have done, and I do not say that it was Mr. Young *and I do not say for a moment that it was Mr. Purcell, and I do not know who is responsible.*" (Emphasis added.)

The dissent (at R. 2351) omitted the italicized portion above, which showed that petitioners' counsel was explicitly disclaiming any fraud by Young or Purcell, and quoted the first part as the sole basis for its theory that counsel was claiming such liability. This was error.

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* See pp. 60-61, *supra.*

In its post-trial reply brief, plaintiff made it finally clear that it had never asserted any claim of wrongdoing on the part of either Young or Purcell as evidence of fraud by Kirby, and went on to deny that such a claim *could* be asserted in this case. Responding to defendants' contention that the complaint herein should be dismissed for failure to join Young, Purcell and Anzalone as indispensable parties (R. 206, 209-210) petitioners' counsel in their post-trial reply brief asserted:

> "Far from being indispensable parties the absent *Zenn* defendants are not even proper parties and would be entitled to summary judgment were plaintiffs to have sought to join them here. *Taxin* v. *Food Fair Stores, Inc.*, 287 F. 2d 448 (3d Cir.) cert. den. 366 U. S. 930 (1961)." (Plaintiff's post-trial reply brief, p. 45.)

It was only after the District Court found that plaintiff had "completely and utterly" failed to make out any case against Kirby personally that petitioners for the first time in their brief on appeal before the Court of Appeals (pp. 56-59) directly contradicted their prior position and charged "concealment" of material evidence during the *Zenn* hearings (Exs. 362 id.-366 id.) by Young and Purcell.

Petitioners are precluded from raising this new claim here by the salutary principle which protects litigants from having to litigate afresh on appeal new issues which their adversaries never saw fit to raise at trial. *United States* v. *Davis*, 370 U. S. 65, 74n. 9 (1962); *Giordenello* v. *United States*, 357 U. S. 480, 488 (1958); *NLRB* v. *Truitt Mfg. Co.*, 351 U. S. 149, 151 (1956); *United States* v. *New York Tel. Co.*, 326 U. S. 638, 650-51n. 18 (1946); *Van Huffel* v. *Harkelrode*, 284 U. S. 225, 229 (1931); *Vir-*

*ginian Ry.* v. *Mullens,* 271 U. S. 220, 227-28 (1926); *Potter* v. *United States,* 107 U. S. 126, 131 (1882).*

The rationale behind this rule was stated in *Toledo Scale Co.* v. *Computing Scale Co.,* 261 U. S. 399 (1923), another case where an attempt to present additional evidence was converted into a charge of "concealment." This Court observed that:

> "The Toledo Company had a chance to make a defense of the Phinney prior use and failed to do so because of its own lack of diligence. As it did not secure a hearing of the Phinney defense its opponent had no chance to meet it. . . . We can not know what the result of the hearing would have been on this issue if tried, because only one side is presented. We are prevented from knowing it by a most salutary rule of law which after parties have had a full and fair opportunity to prepare their case, refuses to permit them to drag out litigation by bringing in new evidence which with due diligence they ought to have discovered before the hearing. The apparent hardship of particular cases should not and can not weigh against the application of this sound principle. As Mr. Justice Story remarked in *Ocean Insurance Co.* v. *Fields,* 2 Story, 59; 18 Fed. Cas. 532, 'It is for the public interest and policy to make an end to litigaton, or, as was pointedly said by a great jurist, that suits may not be immortal, while men are mortal.'" *Id.* at 424-25.

Petitioners go beyond asking for victory under a new legal theory on the facts found by the trial court. They seek to raise new issues of fact that were never tried.

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* *Accord,* River Plate & Brazil Conferences *v.* Pressed Steel Car Co., 227 F. 2d 60, 63 (2d Cir. 1955); American Air Export & Import Co. *v.* O'Neill, 221 F. 2d 829, 831 (D. C. Cir. 1954); Patent & Licensing Corp. *v.* Olson, 188 F. 2d 522, 525 (2d Cir. 1951). See also de la Rama *v.* de la Rama, 241 U. S. 154, 157 (Holmes, J. 1916).

Although petitioners recklessly characterize the conduct of Young and Purcell (which was not examined below through the normal testing processes of trial) as "fraudulent" and "dishonest", it would be inconceivably unfair now, five years after the action was commenced, eight years after the death of Young, and the dispersal of witnesses who might be called, to require Kirby's counsel to search out the essential proof as to a new issue, since gone stale.

If the "deceit" of Young and Purcell had been presented as an issue of fact for trial, there would have been different interrogatories, depositions, pre-trial statements, and trial proof. Kirby's counsel would have examined Purcell, his personal secretary, clerical staff and all personnel involved at IDS to uncover further proof as to the nature and identity of the documents contained in the two large bags of IDS records, including projections, brought with him from Minneapolis to the *Zenn* hearing, where they were examined for a "few minutes" by the *Zenn* objectants' counsel, Mr. Graubard (R. 580, 596, 2055, 1989. See also R. 401, 298-300, 317).

The surviving members of Young's staff would have been examined, to determine the nature and extent of the IDS documents received by him, his habits in the disposition of such records, and whether the Waag correspondence was among the files of Young and Alleghany that were turned over to the *Zenn* objectants for examination. Mr. Pomerantz (counsel for the *Zenn* plaintiffs), Mr. Graubard (counsel for the objectants), the members of Graubard's "team" who spent 64 hours examining Alleghany's files, Graubard's accountant who worked on the case, and various other representatives of the 22 law firms appearing at the *Zenn* hearings, would have been examined in detail as to precisely the kind of study they made of the files turned over to them, and what their

notes and work papers revealed as to their file searches. Such a procedure would be necessarily more revealing than the present course of speculation—which is all that petitioners are doing—as to the claims that are now made as to Young and Purcell.

At this late date, five years after one limited issue was joined in the present case and ten years after the *Zenn* hearings, much of the proof on this new issue is dead, diluted, or has evaporated. It would be impossible for Kirby to resurrect it. To require him to do so would be manifestly unjust.

## POINT III

**There Is Nothing To Indicate Any Sort of Conspiracy or Joint Action among Young, Purcell and Kirby in the *Zenn* Settlement. The Record Is All to the Contrary. There Is, Therefore, No Ground for Vacating the *Zenn* Judgment as to Kirby on Account of Conduct of Young and Purcell.**

Even if this Court accepted *arguendo* that there was fraud by Young and Purcell (which we show in Point IV to be erroneous) it would be unfair to make Kirby, who is innocent, suffer the consequences of misconduct by others, while allowing the *Zenn* judgment to stand as to Young, Purcell and the Murchisons.* The record fails to support any claim of conspiracy or joint action among Young, Purcell and Kirby. It is all to the contrary.

* As we show in Point V, pp. 148-51 *infra*, the New York Court, having *all* the parties before it, has full power, under C.P.L.R. 5015, to apply equitable principles upon motion to set aside the Zenn judgment, setting aside as to wrongdoers but not others.

**A. Kirby had a right to rely upon the finality of his separate judgment in *Zenn*. The "partnership" theory has no basis in this record.**

The 1949-50 exchange which was under attack in *Zenn* is now sixteen years old. The "concealments" of Young and Purcell are alleged to have occurred over ten years ago; and more than six years have passed since Kirby, acting in good faith, entered into his separate *Zenn* settlement and obtained the *Zenn* court's approval of his settlement and a vacatur of the *Breswick* injunction as to him.

If *Zenn* had not been thus terminated as to him, Kirby would have proceeded to marshal the extensive proof required to defend himself in *Zenn,* which would show that the 1949-50 exchange, when considered in the light of all the circumstances existing at the time of that transaction (and without benefit of the hindsight indulged in by petitioners) was not unfair to Alleghany, and that he did not conceal any material facts from its stockholders.

With the passage of so many years, however, proof as to such complicated matters fades. Witnesses (*e.g.,* Robert R. Young) die. Records available even six years ago can no longer be located. Having in good faith relied upon the finality of the judgment as to him, and having refrained from preparing his defense, Kirby should not be penalized at this late date because of the suspected conduct of others, so recently asserted for the first time.

Apparently recognizing the inherent unfairness in holding an innocent man for the suspected wrongs of others, the dissent attempts, without proof, to remedy this deficiency by asserting that Kirby was a "partner" of Young and Purcell in their suspected wrongdoing, or a member of a "conspiracy" which encompassed their alleged fraud

on the *Zenn court* (R. 2351). Judge Friendly expressed his theory as follows:

> "*A partner* for whose benefit the facts were concealed can no more preserve a settlement thus obtained than the one who was on the front line. If, as the evidence shows, Young, Kirby and Purcell *conspired* to make an unlawful appropriation of Alleghany's investment in IDS Class A Stock, which was then challenged by suit, they remained bound to the end." (R. 2351) (Emphasis added.)

This theory proceeds on the erroneous assumption that "evidence" proved the allegations in the *Zenn* complaint that the defendants had "conspired" unlawfully to effectuate the 1949-50 exchange. But the only judicial officer who has even taken any evidence on the merits of that exchange, the *Zenn* Referee, found no such conspiracy.

Surely, given this record, the alleged conspiracy to suppress evidence in *Zenn* cannot rest on the foundation of casual dicta about the legality of the 1949-50 exchange (Pet. Br. 26, 31, 43). To draw any inferences from these comments, or to give them any weight in this appeal, would be an act of self-levitation without benefit even of bootstraps, breaching fundamental concepts of due process.

Nevertheless Judge Friendly's view is echoed by petitioners, who now charge that "Kirby knowingly joined with his co-fiduciaries in their fraud." (Pet. Br., p. 42.)

The record was made without regard to any such point. How could it be otherwise? Neither Young nor Purcell were defendants in this action. They were not represented by counsel. Under these circumstances, it would be astonishing if the record showed more than an occasional reflection of the relationships among the men. Certainly

it does not contain an analysis, based on testimony and exhibits and tested by cross-examination, of the new issues now raised. Such evidence as the record does contain, however, refutes the inferences drawn by the dissenting judge below and adopted by the present petitioners.

**B. Neither the record nor the law supports a claim based on conspiracy or joint action.**

**1. There is no claim, proof or finding in this record of any conspiracy or co-fiduciary relationship or conspiracy among Young, Purcell, and Kirby in the settlement of the *Zenn* case.**

**(a) There is no basis for asserting that Young and Purcell were Kirby's agents during the *Zenn* settlement proceedings.**

Neither Young nor Purcell had or purported to have any authority to act for Kirby in the conduct of the *Zenn* litigation.

Kirby had not been served in *Zenn* (Ex. 2, R. 729). On the two occasions when he gave someone else the right to act for him in that proceeding, the agency was severely limited as to subject matter and time, and carefully controlled. David Wallace was given the specific and limited authority to execute the Stipulation of Settlement dated July 25, 1955, as attorney-in-fact for Kirby (Ex. 2, R. 736). The subsequent authority of David Teitelbaum was limited to execution of the Supplemental Stipulation of Settlement dated December 24, 1959 as attorney-in-fact for Kirby, and to appearance for the entry of the judgment approving the final settlement (Ex. 29, R. 887).

The best evidence of the emptiness of the claims of "conspiracy" now being made is the fact that the two explicit statements made by petitioners on this subject are unsupported by record references and are, in fact, untrue. At page 16 of their brief, petitioners state:

> "Having convinced the Referee of the unimportance of the February letter, Kirby here takes the opposite argument. . . .
>
> "Having successfully withheld the projections and the other damaging evidence, Kirby, Young and Purcell urged that they 'had no inside information from which they could have foreseen [IDS'] subsequent spectacular rise in value' (R. 1637-1638)." (Pet. Br. p. 16)

The statement that Kirby and Purcell submitted arguments to the Referee is just not true. Neither was served and neither appeared as a party.

The Murchisons were represented before the Referee by the firm of Satterlee, Warfield & Stephens; Alleghany was represented by Peter George Martin, Esq. Mr. Daly filed briefs on behalf of Robert R. Young and Thomas Deegan. No one, however, was left with any doubt as to the fact that Daly did *not* represent Kirby or Purcell, as is clear from the following passages from the *Zenn* hearings:

> "Mr. Graubard: I would like to ask you now of Mr. Daly through you, sir, whether if the Court determines that Mr. Kirby can be examined, that he will make him available for examination?
>
> "Mr. Daly: My answer to that is, first, that I am not Mr. Kirby's attorney. I cannot speak for Mr. Kirby." (Ex. K-355, R. 2088).

• • • • •

> "Mr. Graubard: Mr. Robert Purcell. May I state, sir, that Mr. Purcell has made available to me certain files relating to the transactions in 1950, with his counsel's consent—who is Mr. Daly—and that I am reviewing these files at this time. . . .
> "Mr. Daly: I have no objection to that, Your Honor; but I must make a correction on the record.
> "I am not counsel for Mr. Purcell" (Ex. K-353, R. 1989-1990).

The contemporaneous statements of Mr. Daly destroy the unsupported inferences which petitioners now present to this Court as "proof" of an agency, "conspiracy", or "partnership" among Young, Purcell and Kirby during the *Zenn* hearings.

**(b) There is no basis for asserting that Young, Purcell, and Kirby acted as co-fiduciaries for Alleghany in the *Zenn* settlement proceedings.**

Petitioner talks about Young, Purcell, and Kirby being "co-fiduciaries" (Pet. Br. p. 42). Presumably, this means that they were co-fiduciaries in their relations to Alleghany and its stockholders with respect to the settlement of the *Zenn* litigation.

In this litigation Alleghany was a nominal defendant whose interests were represented by counsel for the derivative plaintiffs and the objecting stockholders. Only they could make a settlement for Alleghany, and they alone had control over the conduct of the litigation for Alleghany. Kirby, Young, and Purcell, with no control over the litigation, and no power to accept a settlement on behalf of Alleghany, could not be termed fiduciaries for Alleghany in the settlement or conduct of the litigation. In fact, Judge Walsh, in granting the *Breswick* injunction to protect the bargaining position of the *Bres-*

*wick* plaintiffs with respect to the claims asserted by them, observed that:

> "The fact that the lawyer [Peter George Martin, Esq.] who represented Alleghany Corporation in executing this stipulation was closely associated with the law firm which represented the directors does not establish collusion. It is not to be expected that the lawyer representing the corporation will be unfriendly with the directors thereof or their counsel. The real adversary party expected to protect the interests of the stockholders is the lawyer who represents the stockholder group. . . ." *Breswick & Co.* v. *Briggs,* 135 F. Supp. 397, 403 (S.D.N.Y. 1955).

**(c) The record shows that Kirby acted independently in making the *Zenn* settlement attacked here.**

The final and complete answer to any claim that Young, Purcell and Kirby were "co-conspirators" or "co-fiduciaries," and not merely co-defendants in *Zenn,* is Kirby's separate settlement. Negotiations for settlement are an expected and normal feature of the ordinary stockholders' suit. *Zenn* proved to be no exception to the rule. After Young's death, Kirby, concerned with the progress of the negotiations, pressed for settlement.* Mrs. Young and the Murchisons declined to join the effort (R. 370). Kirby went ahead on his own, an initiative which ultimately precipitated the settlements of the Young Estate and the Murchisons (R. 2311).

The gravamen of the complaint in the present suit is the Murchisons' attack on Kirby's *separate* settlement.

* Petitioners suggest (Pet. Br., p. 17) that Kirby's concern was a purely selfish one. They overlook the fact that Alleghany was being put to great expense by the pending suits, both in terms of out-of-pocket costs and, more importantly, in terms of the inability of the corporation to carry on its day-to-day activities. Kirby and Ireland, as officers of Alleghany, were acutely aware of these problems of the corporation (R. 380-81).

The charges in the Amended and Supplemental Complaint, drafted by petitioners' counsel, refer to the settlement under attack as "the separate Kirby settlement."* The language of the separate stipulation of settlement that Kirby signed in *Zenn* and the order of Judge McGivern of the New York Supreme Court approving it specifically reserved all rights against Young, Purcell, the Murchisons and the other defendants.**

Judge Friendly sought to support his erroneous assumption of the existence of a "conspiracy," in which Kirby would remain "bound to the end," by reference to the fact that on November 2, 1959, prior to the negotiation of his separate settlement, Kirby sent Young's widow a copy of counsel's letter advising him of his potential liability and had urged that she realize the importance of not having "disharmony in our ranks" (R. 2351-52).

The conclusive answer to the inferences sought to be drawn from this letter is that the record shows it was followed by complete disharmony among the defendants. Mrs. Young advised that she "was not interested" in a settlement (R. 916) and Kirby's representative was advised that "the estate of Young did not want to participate" (R. 371). The Murchisons vigorously opposed it, denouncing it as a separate, "private" Kirby settlement (R. 908).

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* Complaint, pars. 44-45 (R. 177-78); par. 47 (R. 179-80); par. 48 (R. 182); par. 60 (R. 186); demand for relief, par. (c) (R. 187). The principal charge at trial in *Murchison* was the contention, now dismissed and abandoned (see, however, Pets. Br. p. 17) that the separate settlement was obtained by a "corrupt bargain" with Randolph Phillips, who now appears at petitioners' side as amicus curiae.

** See *supra*, pp. 50-51.

Thus, the conduct of the parties when Kirby negotiated his separate settlement shows that Mrs. Young, the Murchisons and Kirby did not consider themselves "bound" in any common course of action, but thoroughly disagreed with each other.

The provisions of the Kirby stipulation, and of the Young and Murchison stipulations of settlement, as incorporated into the judgment of approval of the *Zenn* court, are not only inconsistent with the existence of any "conspiracy" or "partnership" but negate such an inference. Each Stipulation reserved plaintiffs' rights against the other defendants. Each provided that in the event judgment were to be recovered on any claim in *Zenn* against any other defendant, "the amount of the judgment on such cause of action or claim shall be reduced by the proportionate share thereof which [Kirby, in one case, and Young and the Murchisons, et al. in the other case] would have been required to pay had they not entered into the [Supplemental Stipulation or Second Supplemental Stipulation, as the case may be]." In addition, Kirby's Supplemental Stipulation of Settlement provides that one of the objects of this provision was "that defendant Kirby shall not hereafter be liable to any co-defendant for contribution with respect to any cause of action or claim included in this settlement" (Ex. 7, R. 750-56).

This clause shows and confirms the separateness of Kirby's settlement from that of Young, et al.

Petitioners state, apparently as the basis for inferring a relation of agency (Pet. Br. p. 42), that Kirby had joined with Young and Purcell in briefs to the Referee asserting that no inside information existed. This is untrue. Kirby was not represented and no briefs were filed by him or on his behalf.

**2. There is no basis in law for vacating the *Zenn* judgment as to Kirby on account of alleged fraud by Young and Purcell.**

Even were it to be assumed that Kirby had been a co-conspirator in the original 1950 transaction complained of and, therefore, jointly and severally liable for the consequences flowing therefrom, it does not follow that he should, per se, be jointly and severally liable for the conduct of every other member of the original alleged conspiracy in conducting their several defenses to a suit challenging the original transaction, in the absence of some knowledge of, or knowing participation in, the others' misconduct. No such additional conspiracy may logically be imputed from the first.

This was the answer given by the Court of Appeals for the Third Circuit when it was faced with precisely the same question in *Taxin* v. *Food Fair Stores, Inc.*, 287 F. 2d 448 (3d Cir.), *cert. denied*, 366 U. S. 930 (1961)*, which involved an effort to set aside a separate settlement of a conspiracy action. The effort failed and the separate settlement stood.

In *Taxin*, the plaintiffs sought to set aside the settlement on the ground that certain of the defendants had, by false and fraudulent statements, induced plaintiffs to settle. Although plaintiffs conceded that the other defendants had had nothing to do with their co-defendants' false representations, they argued that the settlement must be set aside as to the former too, on the same theory urged by petitioner here—*viz.*, that they had all been co-conspirators on the underlying cause of action which had been settled.

The trial court dismissed the action as to the innocent settlors, holding that as to them the settlement must be

* A decision relied upon by petitioners' counsel before the District Court in opposing Kirby's motion to dismiss for failure to join Young and Purcell as indispensable parties. (See p. 96, *supra*).

allowed to stand. The Third Circuit affirmed, pointing out that:

> "In analogous circumstances the Court of Appeals for the Second Circuit has suggested that it would be inequitable to deny one antitrust defendant the benefit of a settlement and release solely because of fraud, unknown to him, on the part of another defendant in connection with such settlement and release.
>
> * * * * *
>
> "In our view the fatal defect in appellants' argument lies in its failure to respect the limits within which the law confines the responsibility of a conspirator for acts of a co-conspirator. The accepted and prevailing rule has been clearly stated by District Judge Wyzanski in Momand *v.* Universal Film Exchange, D.C.D. Mass. 1947, 72 F. Supp. 469, 475, affirmed 1 Cir., 1948, 172 F. 2d 37, certiorari denied 1949, 336 U. S. 967, 69 S. Ct. 939, 93 L. Ed. 1118: 'Conspirators are chargeable with the acts of their fellows only if the acts are done in the furtherance of the joint venture as all understood it; they are not to be held for what some of the conspirators, unknown to the rest, do beyond the reasonable intendment of the common understanding.' . . . [W]e are not able to imagine any meaningful way in which the obtaining of a release could be, in appellants' own words, 'part of and in furtherance of the continuing conspiracy among the defendants about which plaintiffs complain.' In simple logic a release given on March 28, 1958 could not facilitate any restraint of trade which had already been accomplished." *Id.* at 450-51.

The requirements of *Taxin, supra,* are far more than petitioners can find in this record. See also *Momand* v. *Universal Film Exchange,* 72 F. Supp. 469, 475 (D. Mass. Wyzanski, J. 1947), *aff'd,* 172 F. 2d 37 (1st Cir. 1948), *cert. denied,* 336 U. S. 967 (1949).

The law as to the liability of one who participates with a fiduciary in a breach of trust could not have been in the mind of Judge Friendly because the law is that liability attaches only to one who "knowingly participates" with the fiduciary.* Petitioners must prove not only that Young and Purcell suppressed evidence in *Zenn* but also that Kirby knew of the suppression. The record shows a failure to meet the burden of proving either of these essential elements.

If we assume, *arguendo*, that Kirby, though not served, was some sort of a co-fiduciary of Young and Purcell in the conduct of the *Zenn* litigation by reason of his position as a director of Alleghany, the law will still not support liability of one who has no knowledge of or participation in the breach.**

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* Wechsler *v.* Bowman, 285 N. Y. 284, 291, 34 N.E. 2d 322, 326 *modified*, 286 N. Y. 582, 35 N.E. 2d 930 (1941); Jackson *v.* Smith, 254 U. S. 586, 589 (1921); Irving Trust Co. *v.* Deutsch, 73 F. 2d 121, 125 (2d Cir.), *cert. denied*, 294 U. S. 708, 711 (2d Cir. 1934); Sexton *v.* Sword S.S. Line, Inc., 118 F. 2d 708, 711 (2d Cir. 1941); Gerdes *v.* Reynolds, 28 N.Y.S. 2d 622, 661 (S. Ct., N. Y. Co. 1941); Oppenheimer *v.* Szekeres, 18 App. Div. 2d 627, 628, 235 N.Y.S. 2d 722, 724 (1st Dep't 1962); Lonsdale *v.* Speyer, 249 App. Div. 133, 141, 291 N. Y. Supp. 495, 505 (1st Dep't 1936). As the New York Court of Appeals held in Wechsler *v.* Bowman, *supra*, where defendants who were charged with participating in a fiduciary's breach of trust were not shown to have "*knowingly* aided" in such breach, "the complaint must be dismissed as to those defendants." 285 N. Y. at 295, 34 N.E. 2d at 328. (Emphasis by the court.)

** The law is that directors are not liable for wrongs of co-directors of which they had no knowledge and in which they did not participate. Briggs *v.* Spaulding, 141 U. S. 132, 147, 159 (1891); People *v.* Equitable Life Assur. Soc'y, 124 App. Div. 714, 731, 109 N. Y. Supp. 453, 467 (1st Dep't 1908); Holland *v.* American Founders Life Ins. Co., 151 Colo. 69, 376 P. 2d 162, 165-66 (1962); Jersawit *v.* Kaltenbach, 253 App. Div. 265, 268, 1 N.Y.S. 2d 756, 759 (1st Dep't 1938); Allied Freightways, Inc. *v.* Cholfin, 325 Mass. 630, 91 N.E. 2d 765, 767 (1950); Economy Filling Station *v.* Humble Oil & Refining Co., 3 S.W. 2d 832, 834 (Tex. Civ. Ct. App. 1928); Fisher *v.* Graves, 80 Fed. 590

If it be supposed that there was some trustee relationship between Young and Purcell, and Kirby, the result is no different. Again, "where there are two or more trustees, one of them is not liable for a breach of trust committed by another." 2 Scott, Trusts §224, pp. 1635-36 (2d ed. 1956).*

## POINT IV

### Since the "Concealed" Documents Were Made Available in *Zenn* by Young and Purcell and Were, In Any Event, Cumulative, Petitioners' Questions Are Not Reached.

We have shown that Kirby was not guilty of any fraud or concealment. Assuming *arguendo,* however, that Kirby could be held legally responsible for the conduct of Young and Purcell in *Zenn,* the question of whether petitioners' proposed rule, which would require a director named in a derivative stockholders' suit to search out and volunteer evidence, is still not reached on this record, since the

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(S.D.N.Y. 1897); 3 Fletcher, Cyclopedia of Corporations §1089, pp. 639-40 (1947 replacement vol.). The Rule has been stated: "Clearly, to our mind, a director of a corporation should not be held liable for the false and fraudulent financial statements made by another director or manager of a corporation about which he had no information and over which he had no control." Economy Filling Station *v.* Humble Oil & Refining Co., 3 S.W. 2d at 834.

* *Accord,* Colburn *v.* Grant, 181 U. S. 601 (1901); Ormiston *v.* Olcott, 84 N. Y. 339, 346 (1881); In re Halstead, 44 Misc. 176, 185, 89 N. Y. Supp. 806, 811 (Surr. Ct., Dutchess Co. 1904), *aff'd,* 110 App. Div. 909 (2d Dep't 1905), *aff'd,* 184 N. Y. 563 (1906); Matter of Walsh's Estate, 143 Misc. 223, 225, 256 N. Y. Supp. 870, 872 (Surr. Ct., Suffolk Co.); *aff'd,* 236 App. Div. 809, 259 N. Y. Supp. 975 *appeal denied,* 236 App. Div. 854, 260 N. Y. Supp. 968 (2d Dep't 1932).

record shows (1) that Young and Purcell acted in good faith and did not conceal documents in their possession from the *Zenn* Referee or objectants; and (2) that the "concealed" documents were in any event cumulative or immaterial.

As Judge Friendly pointed out, "some relevant documents will inevitably be overlooked" in complicated litigation like the present case, and "the undesirability of reopening judgments demands that judicial approval be final unless the undisclosed evidence is of real importance and not merely cumulative of other evidence that was received" (R. 2358).

In this case Judge Dawson found as a fact that the documents which petitioners say Kirby should have volunteered, when considered

> "[T]ogether with the documents which were actually introduced before the Referee in the *Zenn* settlement hearings . . . [were not] of such significance that they would warrant the Court upsetting the decision of the State court in any event. . . ." (R. 2324-2325).

Judge Moore wrote:

> "Examination of the 'non-disclosed' documents leads to the conclusion, also reached by the district court, that although the documents would have been admissible had they been offered before the Referee . . . . At most they would have been but cumulative evidence upon the basic issue of Kirby's fraud in acquiring IDS stock. . . ." (R. 2342)

This Court has always regarded itself as "concluded" by concurrent findings of fact of the courts below, in the absence of "very exceptional showing of error." *Comstock* v. *Group of Institutional Investors,* 335 U. S. 211, 214 (1948); *Graver Mfg. Co.* v. *Linde,* 336 U. S. 271, 275

(1949), *aff'd on rehearing,* 339 U. S. 605 (1950); *Pick* v. *G. M. Corp.,* 299 U. S. 3, 4 (1936). No such exceptional showing appears here. The record, in fact, demonstrates the danger inherent in using bits and pieces, offered on other issues, in order to jump to conclusions with respect to a claim not in issue.

An experienced trial lawyer and judge, such as the district judge in the present case, recognizing from practical experience the wisdom of following the processes prescribed by Rule 16, Fed. R. Civ. P., would have adhered to the issues before him rather than speculate from a fragment as to what plaintiff's counsel might have been able to show if they had presented a different claim. Because the issue of concealment by Young and Purcell was not tried before the District Court, Judge Friendly did not have called to his attention testimony and exhibits in the *Zenn* record showing that his suspicions were misplaced. His dissent overlooks, in fact, some important testimony in the present suit.

**A. Evidence not mentioned by petitioners, and not discussed by the dissent, shows that Young and Purcell, acting in good faith, revealed their receipt of IDS projections in 1950 and made them available to *Zenn* counsel.**

The "concealment" attributed by petitioners to Young and Purcell relates almost entirely to IDS earnings forecasts and projections (Exs. 243, 244, 245 id, 246 id.).* Petitioners stress their claim that Young, during the hearings before the *Zenn* Referee, failed to reveal the existence of IDS projections of the type later uncovered at IDS in Minneapolis in pretrial depositions in this case (*i.e.*, annual and 5-year projections). For instance, refer-

* R. 1104, 1119, 1121 and 1136, respectively.

ring to the discussion between counsel on the occasion of Young's deposition in federal *Zenn* as to the existence of such projections petitioners state (Pet. Br. pp. 10, 12):

> "Young sat mute throughout this interchange, failing to mention the existence of any projections, including the one he had received from Purcell."
>
> . . . . . .
>
> Also concealed were IDS' yearly projection for 1950 (R. 1136-1137) and its 5-year projection for the years 1950 through 1954 (R. 1121-1135)."

Judge Friendly was persuaded by these arguments and by the Waag correspondence (Exs. 362 id.-366 id.) that Young had concealed the existence of IDS projections from the *Zenn* Referee, and had left the erroneous impression that the only projections were those in the *Zenn* record (R. 2358).

What Judge Friendly did *not* know, and what the petitioners neglect to inform this Court, is that the "interchange" by counsel, through which Young "sat mute," occurred in *March* 1955 at the very deposition on which Young admitted knowledge of five-year projections prepared by IDS. Having made this admission, there was no need for him to say more. Thus, long prior to Young's *December* 1955 testimony, the *Zenn* Referee and counsel for all parties in the *Zenn* proceeding had been made well aware by Mr. Young and his counsel of the fact that such IDS projections

> (1) had routinely been prepared by IDS (See App. C, pp. 43-44);
>
> (2) had occasionally been received by Young at Alleghany (See App. C, p. 44);
>
> (3) had then been taken by Purcell in 1953 from Cleveland back to IDS in Minneapolis when Purcell left Alleghany to become President of IDS (Ex. 399, R. 1369); and

(4) would be returned by Purcell to New York for examination by the *Zenn* Referee and counsel for the stockholders (Ex. 399, R. 1461-62).

It was *after* the foregoing that Purcell appeared, in January 1956 to testify before the Referee, bringing with him IDS' "files and financial statements and projections and reports and matters of that character." (R. 580-96). When Young appeared before the *Zenn* Referee (in December 1955) he knew that the IDS forecasts to be produced by Purcell (in January 1956) plus Alleghany's production of those IDS records that had not been taken by Purcell to Minneapolis in 1953, would undoubtedly disclose the IDS projections whose existence he had testified to earlier in federal *Zenn*, and that if the *Zenn* objectants had any doubt about this they could easily inspect IDS' files in Minneapolis. He therefore had no motive to conceal the 1954 "Waag Correspondence," one item of which (Ex. 365 id.) revealed that at some time in 1950 IDS had made a projection of its 1950 earnings.

It was Young who first revealed, in his testimony in the federal *Zenn* case, the existence of the IDS projections, and the fact that he had received them at Alleghany back in 1950. The transcript of his testimony (*Zenn* Ex. 4), a portion of which is annexed hereto as Appendix C,* shows that on March 29, 1955, in response to questioning by Haudek, a partner of Pomerantz (counsel for the consolidated plaintiffs in the *Zenn* actions), Young testified that IDS, "as part of the corporation's regular routine," prepared earnings "forecasts" and "projections,"

* Since there was no claim of concealment by Young tried before the District Court, the sole issue tried and appealed being alleged fraud by Kirby, this portion of the *Zenn* record was not introduced below. However, we ask the Court to take judicial notice of this record in the case underlying the instant action. See *supra*, p. 35.

and that "once a year the company would make a projection of its outlook over a period of 5 years"; and that "from time to time" he received these IDS projections and forecasts.* At that time Young's counsel, Daly, said: "If they are available, we will produce them" (Ex. 399, R. 1417).

Young's personal files with respect to the 1949-1950 Exchange were later produced (R. 408, Ex. K-355, R. 2083), as were the files of Alleghany (Ex. K-355, R. 2082). Petitioners' counsel have admitted that there is nothing to show that the "concealed" documents were not made available as part of that production (See their answer (R. 288) to Interrogatory V (R. 225)).

Even now, petitioners apparently do not claim possession and concealment of these reports by Young during the Referee's hearings. They merely claim that copies of these reports were received by Young at some time after their preparation in 1949 and 1950 and that his knowledge of their existence, gave rise to a duty to secure from IDS, in 1955 and 1956, copies of those documents for introduction before the Referee.

During the hearings before the *Zenn* Referee, of course, IDS was under the control of the Murchisons, which was confirmed by F. W. H. Adams, counsel for the Murchisons in *Zenn*, when he was requested by Graubard (objectants counsel), to obtain from IDS certain files bearing upon the 1949-1950 business activities of that company, particularly monthly reports (Ex. 399, R. 1458-60).

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* Note that this disclosure by Young occurred at pp. 90-93 of his deposition in *Zenn* (federal). The occasion when it is charged that Young "sat mute" (Pet. Br., p. 10) occurred at p. 55 of his deposition. Petitioners omit mention of the chronological sequence of events when such disclosure is inconsistent with their pre-conceived theory of "concealment" and "suppression."

Absent some affirmative showing that Young possessed copies of these projections in 1955 and 1956 and did not make them available to the stockholders' counsel in *Zenn*, the charge of "concealment" boils down to a claim that Young should have conducted discovery proceedings at IDS when it became clear that counsel for the stockholders did not choose to do so, despite the fact that he had told both counsel and the Referee that the IDS documents Alleghany had received were then in Purcell's possession (Ex. 399, R. 1458).

As to the charge that Young may have known of the existence at IDS of one-year and five-year projections and did not inform the stockholders' counsel of them, we merely note that during his deposition in federal *Zenn* on March 29, 1955, Young testified that:

> "A. I would say once a year that the company would make a projection of the outlook over a period of five years.
>
> Q. When you speak of a period of five years, you are probably again referring now to maturities as they would be met?
>
> A. Maturities and income and sales and all the activities of the company, a normal budgetary program which most well-run companies have." (App. hereto)

The transcript of this deposition was marked as Ex. 4 before the Referee (Ex. 356, R. 1220). Counsel who examined Young before the *Zenn* Referee were certainly aware of the testimony, since they read from it in questioning other witnesses (Ex. 399, R. 1417). *However, at no time was Young ever questioned with respect to his own testimony; he was never asked to describe the projections he had seen and he was never asked to intercede with the Murchisons concerning their production by IDS.*

Moreover, while Young was being examined, Graubard was in the process of examining the files of Alleghany and Young. In addition to the large number of documents produced earlier in 1955 for inspection by plaintiffs' counsel, Alleghany made available to objectants' counsel during the Referee's hearings more than 28 files of documents and records relating to IDS (R. 408). Graubard, counsel for the objectant Rosen, and three other members of his "team", spent four days going through those files (R. 408-09). It was in the course of examining these documents, and long prior to the end of Young's examination, that Graubard uncovered and put in evidence before the Referee the crucial Purcell report of February 11, 1950 to Young and Kirby (Ex. 345, R. 1186) and the earlier Shipman reports (Ex. K-294, R. 1933; Ex. K-295, R. 1951).

The Purcell report reviewed the major accomplishments during Alleghany's first nine months of control of IDS, and dealt with the IDS earnings forecast for the coming year. It was not a casual communication but, from its tone and detail, was carefully prepared. It reported increasing earnings for all of IDS' departments, and did not (as the dissent erroneously suggests, R. 2359-60) limit itself to the Mortgage Department. Since the Mortgage Department, however, was the most important one from an earnings standpoint Purcell gave the specific figures with respect to it, stating (R. 1189):

> "During 1950 the Mortgage Department forecasts, conservatively, $8,315,000 gross income from mortgage operations (not including interest), with a net, before home office expenses, of $5,720,000. I am told that these are very conservative estimates and take into account only business which is presently on the books."

No "projection kit" was needed for Graubard and his accountant quickly to learn that this projected net income alone was nearly four times the amount of IDS' net operating income from all departments in 1949. It was equivalent to $19.61 per share of IDS stock for 1950, even without any profit from any of IDS' other departments, which were reported by Purcell to be enjoying increased revenue (Ex. 345, R. 1188).

On November 17, 1955, Purcell's letter of February 11, 1950 to Young and Kirby (Ex. 345, R. 1186) was marked as *Zenn* Ex. 327. Graubard followed this up with a letter to the *Zenn* Referee (Ex. K-292, R. 1898), demanding that Purcell be required to appear for examination. He described Purcell as follows:

> "He is the person who was said to have been in direct charge of IDS matters for Alleghany in 1949 and thereafter. He is the person who allegedly gave information directly to Mr. Young and Mr. Kirby about IDS. He is the person who, according to Mr. Young's testimony, presumably removed from Alleghany its IDS files and who has thus far refused to make available any but a small portion of these essential papers. Mr. Purcell still occupies a position of prominence at IDS, which is now under the control of defendants Murchison Brothers." (R. 1902)

Purcell appeared before the *Zenn* Referee on January 5, 1956, after the examination of Young had been concluded, and brought with him, as he later testified:

> "all of my [IDS] files and reports and everything that I could, and I remember coming into the courtroom with an enormous briefcase in one hand and a great enormous red manila folder under my other arm. . . ." (R. 580)

Purcell further testified below that these large bags contained IDS "files and financial statements and projections and reports and matters of that character" (R. 596); and "I had a large package of reports, including some projections, because it was my practice to keep those projections" (R. 598); and "I brought everything I had and it was my practice to keep the projections." (R. 600).

Objectants' counsel (Graubard), however, examined this mass of IDS records for only "a few minutes"* (Ex. K-353, R. 1989) because in the meantime he had evaluated the Purcell report of February 11, 1950 to Young and Kirby (Ex. 345, R. 1186) and the Shipman Reports (Exs. 294, R. 1933 and Ex. 295, R. 1951), which had been produced by Alleghany earlier. As his later memoranda before the New York Supreme Court confirmed (Ex. K-41, R. 1509-10, 1513-14) he believed, like any cautious cross-examiner that these records "proved" his case (R. 399) and that if he persisted in introducing additional, cumulative evidence of the same type, he took the risk that Purcell, who probably knew more about IDS than anyone else, would explode his efforts to inflate the optimistic IDS earnings forecasts by showing their limited reliability (without the aid of hindsight). His challenge (Ex. K-292, R. 1902) to produce Purcell and his IDS records had been met. He therefore decided to let well enough alone.** Purcell was not asked

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* At the outset Graubard asked "May I therefore request that we have a few minutes so that I may glance through these files." (R. 1989) The length of the transcript of Purcell's testimony for that day attests to the fact that Graubard did not take very long in this process. Purcell's deposition, which proceeded from 10:30 A.M. to 4:30 P.M., covers 130 typewritten pages, which would normally require continuous examination for the day, excluding a lunch hour.

** We shall show (pp. 133-34, *infra*) that his lawyer's judgment was correct, since Exhibit 245 would have destoyed his entire factual premise that the "inside information" showed a *rising trend* of earnings. It showed only a *non-recurring bulge.*

a single question about IDS projections. He was not even asked about his own letter of February 11, 1950 to Young and Kirby, which Graubard thought "proved [his] case" (Ex. K-353, R. 1989-2059). Testifying in the present case Graubard explained his *Zenn* hearing strategy as follows (R. 399):

> "The Court: Did you feel that the information you had received was sufficient for your needs or did you feel it was not?
>
> "The Witness: Your Honor, I felt that I had made a substantial case with the information supplied to me. I felt I had proved my case. The Court decided otherwise."

At the conclusion of his testimony in *Zenn,* Purcell announced to the fifteen attorneys present and representing the complaining stockholders of Alleghany that:

> "This company [IDS] produces a very large number of reports, many of which I brought here today, that nobody has asked me about." (R. 2055)

Purcell was inviting objectants' counsel to explore the IDS reports with him! Graubard, however, preferred to stick with his trial strategy rather than take such a risk. Certainly petitioners are not justified now in charging Young and Purcell with "concealment," "deceit," and a "plot to defraud" because of Graubard's tactical decision not to examine Purcell with respect to the large number of IDS reports which he had brought with him. Nor are present counsel privileged to cry "fraud" because they think they would have done a better job than stockholders' counsel in *Zenn.*

Young's frank and forthright testimony in the *Zenn* proceedings as to the existence, and his receipt, of IDS forecasts including five-year projections; Purcell's production

before the *Zenn* Referee of the two large bags containing IDS projections, coupled with his clear and uncontradicted testimony, and his invitation to counsel to explore the IDS records with him; the production of the Purcell letter of February 11, 1950 and the Shipman reports; all of these undisputed facts are inconsistent with any "concealment" or "plot to defraud." If Young and Purcell had indeed been engaged in a fraudulent effort to keep from the *Zenn* court evidence of what they had known in 1949-50 about the future of IDS, would Young have revealed the existence and receipt by him of the IDS projections and forecasts? And would Purcell have invited interrogation about these records?

Once Graubard and Pomerantz were advised of the existence of routine IDS projections and the fact that they had been received by Alleghany and taken back by Purcell to IDS in Minneapolis, Young had no motive to conceal them, since he and his counsel were well aware of the fact that the law entitled objectants' counsel to examine these records in the IDS Minneapolis files and to introduce them in the *Zenn* hearings. The New York Civil Practice Act* (then in effect) and Rule 130 thereunder permitted any party to obtain an order from the New York Supreme Court for the examination of such records in another state, which Minnesota courts were obligated to enforce. 27A Minn. Stats. Ann. R. 26.01 *et seq;* 38 Minn. Stats. Ann. §597.18.

Petitioners will undoubtedly quote out of context (as they did below**) Graubard's testimony in this case, given almost eight years after the *Zenn* hearings, for the propo-

* Sections 294, 296, 301, 302 and 309, New York Civil Practice Act; Rules 128, 130, 131, 132, and 133, New York Rules of Civil Practice.

** Appellant's Reply Br. to the Court of Appeals, p. 37.

sition that if he had seen a 1950 IDS projection shown to him by counsel (Ex. 246) he probably would have introduced it in evidence (R. 401). Graubard's complete testimony on this subject, however, including the first part of his quoted answer, reveals that he first testified with respect to IDS projections as follows:

> "Q. I ask you if you ever saw projections covering an entire year in that form before?
>
> "A. Mr. Updike, in stating that I do not recall, I think in the interest of justice I better be accurate. We had made available to us, and by 'We' I mean my firm, there were several of us working on these files, we had available to us some thousands of documents and we were given but a limited time to go through these documents in order to keep up with the proceedings before the Referee. Whether or not any of these documents or their like were examined by any of the persons on our team at that time, and then not made use of, either intentionally or through error, I cannot now tell you." (R. 401)

When he was shown various other IDS projections he repeatedly testified that he could not recall whether he had seen them, giving such answers as (R. 398-399):

> "A. I could not now tell you, sir, the record will speak for itself. I just don't recall. We did introduce several hundred documents, but I cannot tell you whether or not this information was covered." (R. 398)
>
> "Q. Do you have any recollection now that any projections or forecasts were furnished to you in connection with those hearings?
>
> "A. Yes, sir. I believe that the record will show that there were forecasts, that my briefs to the referee and to Judge McGivern lay stress upon these forecasts, and I have a particular recollection

indeed of mention of these forecasts in correspondence between Mr. Purcell and Mr. Young." (R. 399)

"A. I do not recall whether I saw a document precisely like this (Ex. 348) or resembling it." (R. 400)

Statements by Graubard to the effect that "the poor Alleghany files are emaciated. . . ." (Ex. 399, R. 1415) did not, as the dissent urges (R. 2357), indicate that Young had concealed IDS reports received by Alleghany but referred to the fact, already testified to by Wallace (the witness who was at that time on the stand (R. 1415)), that when Purcell went to IDS in 1953, he took with him to IDS in Minneapolis the reports previously sent by IDS to Alleghany, including those going back as far 1949 and 1950 (Ex. 399, R. 1380). It is significant that immediately following this statement by Graubard he again requested the return of these files kept by Purcell in Minneapolis and was advised that they were being obtained by Wallace (Ex. 399, R. 1415).

The record is clear that prior to Purcell's production in January 1956 of those IDS projections he had taken with him to Minneapolis, Alleghany and Young did make available to objectants' counsel all their files (R. 408; Ex. K-355, R. 2082-83). For instance, Graubard, counsel for the objectants, advised the Referee:

"I want to note for the record, Your Honor, that counsel for Mr. Young made available to us Mr. Young's personal files relating to the 1950 IDS transaction, and that we have had the benefit of going through those files" (Ex. K-355, R. 2083).

In cross-examining Young before the *Zenn* Referee, Graubard asked whether a folder of IDS documents that

had been sent to Wallace contained all the files which had been taken by Purcell (Ex. 399, R. 1458). If Young were concealing IDS earnings forecasts he would have disclaimed any knowledge of Purcell's files. Instead, he stated unequivocally: "I am sure that Mr. Purcell has more files than that, if you include his files in Minneapolis." (Ex. 399, R. 1458).

These were the IDS files Purcell brought with him on January 6, 1965, made available, and invited Graubard, who examined them for a "few minutes" to make them the subject of interrogation.

**B. The documents claimed to have been withheld by Young and Purcell were Cumulative.**

We review here each of the documents relied upon by the petitioners in the new charge of concealment by Young and Purcell.

**(1) "The Waag Correspondence" (Pet. Br. pp. 9-11)**

These documents (Ex. 362 id.-366 id.) were prepared after the 1949-50 exchange. They would not, therefore, have been relevant as proof of information known to Young and Purcell prior to their decision to take part in the 1949-50 exchange. That commitment was certainly made prior to February 24, 1950, the date on which their offer to exchange was accepted by the Alleghany Board (Ex. K-208, R. 1853).

Ex. 363 id. and Ex. 364 id. (R. 1344-46) were before the Referee as *Zenn* Exs. 97 and 98 (Ex. K-310, R. 1980; Ex. K-311, R. 1982).

A third document, Ex. 366 id. (R. 1359-60), is a handwritten note from Purcell to Young dated July 27, 1954.* The irrelevance of this "informal memorandum, jotted by one defendant to another while settlement negotiations are in progress" was noted in the concurring opinion below. (R. 2348n)

The fourth document, Ex. 362 id. (R. 1342), is a covering letter sent to Purcell at his farm on July 26, 1954 by Norman Waag, the controller of IDS, four years after the 1949-50 exchange. It described the series of documents (Ex. 363 id.-365 id.) enclosed in his letter. It does not state that these had been sent to or seen by Kirby or any other *Zenn* defendant in 1950, i.e., prior to the exchange transaction, so that they would not prove inside information known to them at the time of the transaction.

The significance attached by petitioners to this letter (Ex. 362) is that it refers to the large increase in income from mortgage operations of IDS during 1950, encloses an income statement for the year 1950 comparing annual income to the amounts of income which had been previously projected and then states that "this projection was most likely completed in January of 1950 which would indicate that we accomplished a considerable improvement in our mortgage operations" (Ex. 362 id., R. 1343). No attempt was made below to support the contention, made by Judge Friendly and now adopted by the petitioners, that Waag's letter proves that IDS projections for all departments

* Judge Kaufman, in his concurring opinion (R. 2348, n. 1) noted that in using the phrase "This may not be too helpful," Purcell was apparently referring to a fact later in evidence before the *Zenn* Referee, namely, that IDS' actual income for 1950 was $8,600,444 as compared with its 1949 income of $1,515,401, rather than to the projection of $5,992,168 (R. 2348).

were available to the *Zenn* defendants in 1950 before they committed themselves to the exchange. The record refutes any such inference:

(a) The projection for the year 1950 alone (Ex. 246 id., R. 1136) was not prepared until April 14, 1950.

(b) The date of preparation of the projection for the five-years 1950-1954 (Ex. 245 id.) was not proved below. The only reasonable inference, however, is that it was prepared later than April 14, 1950, since the projection includes figures for the Mortgage Department for each of the years 1950, 1951, 1952, 1953 and 1954; and as late as April 26, 1950, that department still considered its projection for the year 1951 to be in the "preliminary" stage (Ex. 351, R. 1208). There is nothing to indicate when the 1951 figures were put in final form, much less when the figures for 1952, 1953 and 1954 were prepared.

(c) If any inference is to be drawn, the logical one is that Waag's reference to a January projection was to a projection of 1950 mortgage income prepared by the Mortgage Department in January:

(i) Ex. 351 (R. 1210) recites (R. 1213) that "early" in 1950 a projection of mortgage department profit and loss figures was presented to the Board of Directors;

(ii) Waag's comment is made in the course of his discussion of the unusually fine showing by the Mortgage Department in 1950.

The Mortgage Department projection made "early" in 1950 was, however, known to the *Zenn* Referee and was relied on by counsel for the *Zenn* stockholders (Ex. K-41, R. 1519-20). It was summarized by Purcell in his letter of February 11, 1950 (Ex. 345, R. 1189), which was *Zenn*

Ex. 327. The accuracy of Purcell's summary is evident from a comparison of his letter with the actual January projection, which appears at R. 1210.

There is, therefore, no information in the Waag letter as to IDS projections which was not before the Referee in *Zenn*.

The final exhibit in this series, which is the document on which the dissenting judge in the Court of Appeals relied most heavily and which the concurring judge recognized to be the document "crucial" to the position of the dissent (R. 2348), is Ex. 365 id. (R. 1347). That document, consisting, in part, of the Summary of Operations of IDS for the year ending December 31, 1950, was quite obviously prepared some time after the end of that year. It would not itself, therefore, have been relevant to the issues before the Referee in *Zenn*.

The significance which Judge Friendly and the petitioners attach to this letter is that it would have provided a clue to the *existence* of such projections inasmuch as it compared actual 1950 results with the results which had been projected at some earlier date. If so, it is clearly cumulative of other evidence in the *Zenn* record:

(i) Young's testimony (App. C, pp. 43-44) about IDS projections and the many *Zenn* exhibits discussing and quoting from such projections, some of which had been filed with the SEC (pp. 34-36, *supra*).

(ii) Purcell brought such IDS projections to the *Zenn* hearings (R. 598-600).

(iii) The record before the *Zenn* Referee was full of "clues" as to the existence of such IDS projections. (see pp. 34-36, *supra*). The single column of projected earnings appearing on the 10th page of a twelve-page report (Ex. 365 id, R. 1353) was merely cumulative of the other

"clues." The report itself (Ex. 365 id.) may very well have been included in the thousands of documents in Alleghany's files which Graubard's team examined (R. 401) or among the IDS reports in the two "enormous" bags produced by Purcell and examined for only "a few minutes." (R. 580, 598, 600; Ex. K-353, R. 1989).

### (2) "The Projections and Actuarial Studies" (Pet. Br. pp. 11-12)

Four of the five documents in this category were discovered in the files of IDS during pre-trial discovery proceedings in the instant action.

#### (i) *The Froggatt & Co., Actuarial Report, Ex. 220 (R. 1053)*

This document, found in the files of Alleghany, was the report of Joseph Froggatt & Co., Inc., dated April 29, 1949 (R. 1053). This particular report was identified by title and date and quoted from in other exhibits introduced before the *Zenn* Referee (Ex. K-358, R. 2125; Ex. K-359, R. 2148; Ex. K-361, R. 2171; Ex. K-295, R. 1958) which have already been fully discussed at pp. 86-88, *supra.*

Petitioners' counsel has conceded that this report may have been in the files made available to Graubard (R. 225, 288). The Alleghany files were made available to counsel for the *Zenn* stockholders (Ex. K-353, R. 2082). Graubard testified below that he was satisfied, during the *Zenn* hearings, that the files had not been tampered with, based on the kind of material he found in them (R. 409).

#### (ii) *IDS 1949 Income Projections Ex. 243 (R. 1104) and Ex. 244 (R. 1119)*

Exhibits 243 and 244 are IDS projections prepared during 1949. Exhibit 244, dated April 12, 1949 (R. 1119), forecasts net income for the year 1949, by months, and pre-

dicts a total net income for the year of $1,334,400. This information is cumulative of the more accurate information already before the *Zenn* Referee:

(a) The exhibit refers only to the full year 1949, and the charge in *Zenn* was directed to the non-disclosure of favorable earnings developments "during the latter part of the year 1949 and the early part of the year 1950" (Ex. 1, R. 704), as to which Ex. 244 is silent;

(b) The actual results for 1949 ($1,365,485) were before the Referee in *Zenn* and were more favorable than the projected results ($1,334,400) (Ex. K-358, R. 2123);

(c) Although the actual results for 1949 were not made public until the Annual Report of IDS for 1949 was published in June, 1950 (Ex. K-358, R. 2117), Young and Kirby told the Alleghany stockholders, as early as March, 1950 (Ex. 195, R. 1013), that IDS income for 1949 was expected to be $1,631,100 (R. 1018). This prediction by Young and Kirby was in excess of both actual IDS earnings of $1,365,485 and of the even smaller amount ($1,334,400) which had been projected in Ex. 244.

Exhibit 243 (R. 1104) is an undated projection of IDS net income for a five-year period, 1949-1953, which was prepared by IDS sometime in 1949.

To the extent that Ex. 243 would have provided a "clue" to the existence of five-year projections, it was cumulative of the abundant "clues" discussed at pages 34-37, *supra*, including Young's testimony that IDS made such projections.

To the extent that Ex. 243 projected a steady increase in IDS' earnings curve over the period, it provides the same information which was available from the ten-year

projection on file with the SEC, reproduced in Shipman's report of August 15, 1949 (Ex. K-294, R. 1944-45), which was *Zenn* Ex. 393.

The difference in the amounts projected in Ex. 243 and Ex. 294 would not have been significant in the *Zenn* hearings, especially in view of the enormous deficit in certificate reserves reflected in the 1949 IDS Annual Report (Ex. K-358, R. 2125). The amounts projected in each report are as follows:

| | Ex. 243, R. 1104 | Ex. K-294, R. 1933 (*Zenn* Ex. 393) |
|---|---|---|
| 1949 | 1,334,400 | 957,3395 |
| 1950 | 1,649,200 | 1,346,210 |
| 1951 | 2,268,500 | 1,577,550 |
| 1952 | 3,026,000 | 2,009,350 |
| 1953 | 3,642,100 | 2,685,450 |
| 1954 | (not covered) | 3,361,050 |
| 1955 | (not covered) | 3,135,350 |
| 1956 | (not covered) | 5,090,850 |

### (iii) *IDS' 1950 Five-Year Income Projection (Ex. 245 id., R. 1121)*

Exhibit 245 id. is an IDS income projection for each of the years 1950 to 1954, inclusive. It may have been included in the voluminous records produced by Purcell at his *Zenn* deposition on January 5, 1956, and examined for only a "few minutes" by Graubard (R. 580; Ex. K-353, R. 1989). In any event the existence of such five-year projections was well known to the *Zenn* plaintiffs and objectants and Graubard had good reasons for not selecting it from Purcell's bags of IDS forecasts and other

reports for introduction into evidence. It was not only cumulative, but it was potentially harmful to his case.

To the extent that Ex. 245 id. predicted IDS' 1950 income at $7,140,850, or $24.56 per share, it was cumulative of the earnings forecast by Purcell (in his February 11, 1950 report to Young and Kirby, Ex. 345, R. 1189) of $5,720,000, or $19.61 per share, from mortgage income alone plus an upward surge in IDS' three other departments which would add substantially to this figure.

But, petitioners urge, Ex. 245 also projected IDS' earnings for the years 1951 through 1954. It was this very prediction that was dangerous to Graubard and shows why he did not want Ex. 245 id. in evidence. After making its optimistic (but cumulative) prediction of 1950 income, Ex. 245 id. forecast that IDS' earnings would drop sharply from $7.14 million in 1950 to $3.86 million or $13.28 per share in 1952, which would represent only 54% of the 1950 earnings. This evidence was in direct conflict with the allegation of the *Zenn* complaint (Par. 14(b)) that IDS' 1950 earnings of $20.76 "reflected a trend to further improvements which was foreseeable to and foreseen by the individual defendants." (Ex. 1, R. 704). Exhibit 245 id. showed, on the contrary, that the 1950 earnings were being forecast as a temporary "windfall" profit, good for a year or so, to be followed by a sharp 46% decline.

By not offering Ex. 245 id. in evidence Graubard could, and did, urge that Purcell's 1950 forecast was just a "trend" which showed that the *Zenn* defendants had "reason to believe when they took the IDS Class A stock that these substantial earnings would continue and in fact spectacularly increase." (Ex. K-41, R. 1519). Ex. 245 id. would have destroyed such an inference.

Furthermore, although Ex. 245 id. was properly found to be cumulative by the courts below, it is fatally defective as proof, for the reason that there is no proof that it would have been relevant to the issue posed by the first cause of action, *i.e.*, the state of the defendants' knowledge in the "early part of the year 1950" (Ex. 1, par. 14, R. 704).

Ex. 245 id. is undated. It contains no indication of the date it was prepared. Although Purcell testified below that he had received projections in 1950, (R. 554) petitioners' counsel refrained from asking him, or establishing, when Ex. 245 id. was prepared. They now rely on Waag's conjecture, in a letter written four years after the event, as proof (Ex. 362 id., R. 1343). Even as to that letter, counsel never asked Purcell, to whom the letter was addressed, whether Ex. 245 id. *was* the projection referred to by Waag as probably having been prepared in January 1950.

If any inference is to be drawn, it is that Ex. 245 id. was not prepared until after the Alleghany stockholders' meeting of May 3, 1950, which would have made it irrelevant to the *Zenn* issues. Since Ex. 245 id. was a five-year projection, forecasting IDS income for each of the years 1950-55, it would have been prepared subsequent to the shorter one-year projection of income for 1950 (Ex. 246 id., R. 1136), which was not issued until April 14, 1950. Moreover, early in 1950 the Mortgage Department prepared a forecast of net income for 1950, which was reported in Purcell's letter of February 11, 1950 (*Zenn* Ex. 327) as being $5,720,000 (Ex. 345, R. 1189). By April 14, 1950, when the one-year 1950 projection for the entire company was prepared (Ex. 246 id., R. 1136) this figure had been refined, and the amount forecast was $5,372,900. This latter amount was carried over to the five-year forecast (Ex. 245 id., R. 1121).

As late as April 25, 1950, however, the IDS projection for the next year, 1951, was still in the "preliminary" stage (Ex. 351, R. 1208) and was estimated at $3,770,000 (R. 1212). Still remaining undone, before the five-year projection could be completed, was the final refinement of this 1951 projection (which was changed to $2,625,000 (R. 1121) by the time it appeared in Ex. 245 id.) and the similar preparation, analysis and refinement of projections for each of the years 1952, 1953, and 1954.

Petitioners have the burden of proof in this case. Their decision not to risk proving when Ex. 245 id. was prepared was deliberate. They should not now be allowed to infer on appeal a fact which they failed to prove at trial.

For these reasons Ex. 245 id. was properly found by both courts below to be cumulative.

### (iv) *IDS 1950 Income Projection by Months (Ex. 246 id., R. 1136)*

This projection of IDS' 1950 income, dated April 14, 1950, predicted earnings for that year of $7,140,850, or $24.56 per share, which is the same figure forecast in Ex. 245 id. for that year. For the same reasons stated above, page 131-132, it is clearly cumulative of the earnings forecast for the year 1950 in Purcell's report of February 11, 1950 to Young and Kirby (Ex. 345, R. 1186).

Unlike the Purcell report, which was dated just before Young and Kirby committed themselves to the exchange, and was addressed to them personally, Ex. 246 id., dated April 14, 1950, appeared long after they committed themselves (February 24, 1950) and was not directed to them, so that its relevance and admission in *Zenn* would be doubtful, in contrast to the Purcell report.

**(3) "The Stiver Reports" (Pet. Br. pp. 12-13)**

Two reports were prepared for Alleghany by the Cleveland investment firm of Saunders, Stiver & Co. One, a *Zenn* exhibit (Ex. K-293, R. 1906), was dated January 10, 1949. The other, not a *Zenn* exhibit, was dated March 15, 1949 (Ex. 310, R. 1980). Petitioners assert that "[t]he concealment of the second was deliberate" (Pets. Br. p. 12).

It is the petitioners who fail to reveal the true state of the record as to this exhibit. The record facts which demonstrate its cumulativeness and the absence of any concealment, are set forth in full at pages 88-90, *supra*.

**(4) "The Monthly Reports" (Pet. Br. pp. 13-14)**

The "monthly reports" of whose concealment petitioners complain are Exhibits 240, 241 and 242, which were produced from IDS' files pursuant to routine pre-trial discoveries in this case (R. 266-67). They are the Summaries of Operations of IDS for the months of January, February and March, 1950, respectively (R. 1070, 1081, 1092). The Summaries for January and February were not prepared until April 12, 1950 (Ex. 240, R. 1070, Ex. 241, R. 1081). The Summary for March was prepared on April 24, 1950 (Ex. 242, R. 1092). All three exhibits were found in the files of IDS during pre-trial discovery in this action.

The report of earnings contained in these Summaries of Operations is duplicative of the information contained in three *Zenn* exhibits (K-180, K-181 and K-182). A comparison, for instance, of Ex. K-182 (R. 1842) with Ex. 242 (R. 1092) shows that Ex. K-182 contains the same information and, in fact, gives a much more detailed analysis of income and expense items.

The only difference is that Ex. 242 contains, on two of its ten pages, a comparison of actual income with the

amount which had been projected for the period January-March 1950. Exhibit 242, however, contains no projections for any period of time beyond March 31, 1950. It therefore did not show that the *Zenn* defendants had any IDS information other than what the *Zenn* Referee inferred that they had from the other exhibits before him.

Petitioners state that these three reports were clues that "would have given away the fact that such projections existed and were regularly prepared at IDS" (Pet. Br. p. 13). Graubard, however, was well aware of the fact that IDS prepared projections (R. 399). He so testified in this action (R. 399). The *Zenn* record directed the attention of all parties to their existence. One *Zenn* exhibit (Ex. K-354, R. 2060), which identified each of the IDS reports sent to Young, specifically listed IDS' "Summary of Operations"!

If anything, these reports would have detracted from Graubard's case. They showed that for the first quarter of 1950, actual income was lagging behind projected income. Mortgage Department income, the most important single item in 1950, was more than 15% lower than the projected figure.*

The Summaries of Operations were at best cumulative of the much more optimistic forecast contained in Purcell's letter of February 11, 1950 (Ex. 345, R. 1189). The courts below were clearly correct in so finding.

**(5) "Young's and Purcell's Testimony" (Pet. Br. pp. 14-15)**

Petitioners' contention that when Young and Purcell testified before the Referee, they "persistently cried down

* These are more examples of the very limited weight and value attached to such projections, which are characterized by economists as a form of "economic astrology." (See N. Y. Times, March 28, 1950, p. 40, Col. 7, quoting economist Q. Forrest Walker.)

the prospects of IDS at the time the stock was taken" (Pet. Br. p. 15) is refuted by the *Zenn* record. Although they pointed to the serious risks presented by IDS as an investment in 1949 and the highly speculative nature of the venture, they also testified that if these risks could be surmounted (as they later were) it had a very promising future. The *Zenn* Referee had before him, and quoted, the 1949 Annual Report of Alleghany (Ex. 195, R. 1018), wherein Young and Kirby stated to the Alleghany stockholders regarding its investments in IDS:

> "The outlook for eventual profits is considered to be unusually promising."

Purcell, furthermore, testified before the Referee to his own purchases of IDS stock on the open market in late 1949 and in 1950, indicating that he considered it a good speculation (Ex. K-353, R. 2046). This was not the testimony of someone trying to "cry down" the investment value of the IDS.

### C. Summary

This tattered nosegay of passed-over, cumulative documents is supposed to be the wellspring of an extravagant charge of conspiracy to defraud. Misled by their taste for melodrama and their preoccupation with plots, petitioners forsake fact for suspicion (Pets. Br. pp. 34-35), and label every document a deceit, no matter how cumulative. By not viewing the transactions at issue in the context of economic reality, they fail to see them as business problems and fail therefore to understand the motives of Kirby and the reasoning of the Referee. Reality is far less dramatic than the idea of endless conspiracy. But it is also closer to the texture of everyday life. The petitioners would have this Court approach their case wearing blinkers, focusing on one segment of a living economic

process, and excluding all the rest. This is the path to arid conceptualism. The events at issue here are unintelligible unless they are viewed as part of the financial history of Alleghany and IDS during the turbulent postwar readjustment of the American economy and the beginning in 1950 of its prolonged period of recent growth.

In 1949, as the Referee fully perceived, Alleghany was a company emerging from a twelve-year struggle with insolvency. It had just begun to throw off the threat of bankruptcy, and to clear its financial structure of the accumulated barnacles of depression by recapitalizing its preferred stock. In the course of these various steps, it made an investment in IDS which was then under water (R. 586), but which turned out fabulously well—far better than was dreamed of at the time, or much later. Such strokes of fortune happen, and will continue to happen, without fraud or dishonesty. The fate of IDS is hardly unique in the American economy. Every bridge club hears the laments of those who wish they had bought Xerox, or IBM, or DuPont, or Syntex, or some other investment that has risen spectacularly.

But such a rise does not prove that there was a plot behind it, or that Kirby and Young undertook the exchange in 1949 and 1950 because they had secret knowledge about the future.

It is true that in the years following the 1949-50 exchange, IDS' management successfully resolved its problems with the regulatory authorities and took energetic advantage of the opportunity offered to it and to other savings institutions by the long surge of economic expansion following the outbreak of hostilities in Korea in June 1950. But there is no evidence that Young, Kirby or Purcell had "inside information" that this would happen, much less that they "concealed" it.

IDS' actual earnings for the entire year 1949 amounted to $4.70 per share (Ex. K-358, R. 2121, 2123). Its earnings for the six months ending June 30, 1950, amounted to $9.74 per share (Ex. K-173, R. 1807, 1809). Even after this sharp increase (as distinguished from forecasts) became publicly known in the summer of 1950, the market price of IDS' stock rose, by the end of July 1950, to only $13.50 bid, $14.50 asked. Indeed, on July 24, 1950, the President of IDS, who was certainly aware both of his company's projections and of the large increase in its actual earnings, arranged to sell his 3,034 IDS shares for $20 per share (Ex. 399, R. 1385). If the forecasts of IDS were relied upon (without benefit of hindsight) as much as petitioners would have this Court believe, it is hard to understand why Mr. Crabb would have sold for $20 per share a stock which had earned $9.74 per share after taxes in the previous six months, if his forecasters' projections that it would earn $86.99 before taxes, within the next four years could be relied on as a "sure thing."

With the resolution of IDS' controversies with the SEC in 1952, and the general rise in the popularity of mutual funds, the period of IDS' prosperity genuinely began. Then, but only then, did the market conclude that high IDS earnings were more than transitory. But this is precisely what Kirby did not know and could not have known in 1949 and 1950.

The Referee's task was to weigh the two theories of the transaction we stated at pp. 40-42, *supra*. He concluded as he did, not because he was misled by the absence of the petitioners' dozen documents, but because he examined the 1949-50 exchange realistically, and in its full setting as of the time it occurred. One can reach petitioners' view of these events only by myopic hindsight concentration on one facet of the situation—the rise in value of

IDS stock—and refusal to consider the whole of which that event was but a part.

The Referee appraised the economic and financial position of IDS at the time. He examined the essential evidence about its past and future, including a great deal of evidence about its promising prospects in 1949 and early 1950. The substance of the argument here was made to him on the basis of evidence which Judge Moore and Judge Kaufman below thought was cumulative of that offered there. Their view, we must assume, was shared by at least two other members of the Court of Appeals.

The concurrent findings of the courts below should be affirmed.

## POINT V

**No Need Is Shown for a Rule Requiring a Defendant To Search Out and Volunteer Evidence, Since (1) the Case Is Based on Deliberate Deceit and (2) Adequate Remedies and Sanctions Are Available Without Such a Rule. In Such Situations, This Court Normally Remits the Parties to their Remedies under State Law.**

Petitioners argue their case at two levels. On the one hand, they claim that Kirby "deceived" the *Zenn* court by deliberately concealing IDS income projections. On the other, they propose a rule drawn from §14(a) of the Securities Exchange Act, 48 Stat. 895 (1934), 15 U.S.C.A. §78n (1963), which would require Kirby, a defendant in contested litigation, to search out and volunteer in *Zenn* some 12 after-discovered documents despite the absence of conscious concealment or misrepresentation on his part. The *Zenn* court's failure to enforce such a standard, they say, justifies collateral attack by a federal court on the *Zenn* judgment.

We deal with the merits of their argument derived from §14(a) in Points VI and VII (pp. 161-93, *infra*) and with its policy consequences in Point VIII (pp. 194 *et seq.*, *infra*).

**If this case is based on wrongful intent, guilty knowledge and deliberate concealment, a special rule is not required.**

Throughout their brief petitioners' counsel represent to this Court that their case is based on intentional misconduct on the part of Kirby. Charges that Kirby was guilty of "fraud," "deceit," "evasion," "dishonesty," "unlawful" and "deliberate concealment" of "crucial" evidence, and that Young and Purcell were guilty of the same successful deceit upon the court, are asserted 87 times in petitioners' 50-page brief. Their brief fairly bristles with charges of "concealment" (Pet. Br. 2, 21, 34, 35, 37-39); "evasions" (Pet. Br. 9); "deceits" (Pet. Br. 9); "outright deceit" (Pet. Br. 9); "misled" (Pet. Br. 11); "the concealment . . . was deliberate" (Pet. Br. 12); "successfully withheld" (Pet. Br. 16); "failure . . . to respond honestly" (Pet. Br. 24); "facts which they have selected or . . . tailored" (Pet. Br. 24); "fraudulently induced" (Pet. Br. 25); "dishonest directors" (Pet. Br. 29); "successfully concealed" (Pet. Br. 15); "bribe offer" (Pet. Br. 17); "fraud" (Pet. Br. 23, 25, 34-35, 38-39, 41-46); "deliberate deceit" (Pet. Br. 34); "plot to defraud" (Pet. Br. 43); "conspiracy" (Pet. Br. 43); "insiders fraud" (Pet. Br. 45); and "perjury" (Pet. Br. 17, 39, 42).

These are serious charges. We submit that, in view of the unanimous findings below that Mr. Kirby was not guilty of any fraud, petitioners should not be permitted to make such irresponsible charges while at the same time suggesting that they are not essential elements of their case against Kirby.

Petitioners offer no reason why intentional concealment or deceit practiced upon the court in *Zenn* should be treated as any more serious, or more to be condemned, than concealment or deceit in any other action, or why it should call for a different remedy.

*Zenn* was found to be a case of common-law fraud, with an incidental §14(a) element. See pp. 40-41 *infra*.

But even if *Zenn* had been a case arising exclusively under §14(a), and therefore governed as to substance by federal "common law", there is no ground here for a double-standard entitling a litigant in such a case to special remedies. The right to be protected against fraud and deceit is of equal, fundamental importance to all litigants in all proceedings.

Petitioners make no showing that new remedies, in addition to those now provided by New York law, are needed to insure the production of evidence and to punish abuse of the court's processes. The comprehensive system of procedures and remedies provided by New York law to ensure production of evidence and punish abuse of the court's processes (see *infra*, pp. 148-51) is fully adequate to deal with the problems petitioners raise. They make no case for a special rule here.

**New York's liberal discovery rules.**

The first area in which to test the adequacy of existing procedures is that of pre-trial practice. Both the plaintiffs and the objectants in *Zenn* had available to them under New York law broad rights to discover and present evidence, including the right to examine each of the defendants, the officers and employees of Alleghany and IDS, and all files and records of these companies that might possibly yield relevant evidence. The record shows that these rights were extensively exercised. As the trial judge noted:

> "The objectants to the settlement had a full opportunity to demand and require any papers which they thought material in connection with this hearing. That they took this obligation seriously was shown. They served a subpoena duces tecum on Alleghany Corporation in response to which more than 28 files of that corporation were produced which Graubard, counsel for the objectant Rosen, and his staff examined for over 64 man-hours. Graubard was satisfied that Alleghany had produced everything in its files called for by the subpoena. Robert R. Young's files relating to IDS were also produced and similarly examined. He testified at length before the Referee with respect to the 1950 Exchange Transaction. Robert Purcell, a director of IDS from the time of its acquisition by Alleghany in 1949 and a former president and then Chairman of the Board of IDS, responding to a subpoena duces tecum served by Graubard, produced a large number of documents. He also testified at length. The hearing on the settlement was well described by the Referee in his report as in the nature of an adversary proceeding. In such a proceeding the proponents of the settlement of course had the burden of establishing the fairness of the settlement. The objectants contested the fairness of the settlement. They had the full discovery proceedings of the State Court at their disposal in establishing their position." (R. 2318-19)

The Court of Appeals gave some of the statistics as to the Referee's hearings.

> "The statistics as to the nature and duration of the hearing are revealing. Eighteen witnesses were called, some 480 exhibits introduced, over 4,600 pages of testimony were taken and twenty-two law firms and attorneys appeared. The hearing on the merits of the settlement was, in effect, a hearing on the merits of the suits." (R. 2333)

The Referee himself later described the scope of the examination as follows:

> "It immediately became clear that the Referee was conducting not a *pro forma* inquiry into a settlement negotiated with counsel for satisfied stockholders but a bitterly contested adversary proceeding without parallel in minority stockholders litigations. Under such circumstances, it was incumbent that I allow objectants to the settlement the broadest latitude in pursuing every possible relevant area of examination and permit them the most searching cross examination of the parties who had actually negotiated the proposed settlement." (Affidavit of Robert J. Fitzsimmons, sworn to May 3, 1960, p. 13, *Zenn* v. *Anzalone*, N.Y.S. Ct., N. Y. Co., Index No. 7244/1954).

Although the *Zenn* plaintiffs and objectants had the right to examine Kirby's files and to study the IDS forecasts in its records in Minneapolis* (of which they were well aware), they chose not to do so. The reason was clear. Graubard believed that he had already made out a case and that additional proof was cumulative and unnecessary; indeed, further examination might well have been dangerous (See pp. 117-22 above).

Petitioners cannot side-step this arsenal of discovery and trial weapons that were available to the *Zenn* plaintiffs and objectants. Although they state (Pet. Br. p. 24) that "reliance cannot be placed on discovery procedures, or even on the adversary nature of litigation, to achieve a fair result," what they mean is that they are not satisfied with the way trial counsel in *Zenn* utilized the ample discovery procedures available to them.

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* *Supra*, p. 122 for the New York and Minnesota laws entitling parties to obtain in New York, and to enforce in Minnesota, broad discovery orders.

**New York enforcement procedures.**

In support of their demand for a special duty of disclosure in *Zenn*, petitioners repeatedly distort Judge Moore's opinion, incorrectly stating that he took the view that upon institution of such litigation the defendant's duty of disclosure completely "evaporated." (Pet. Br. p. 29). (See Point VIII *infra*).

Judge Moore took no such view. On the contrary, he pointed out that as an adversary the director assumed a duty to respond to all subpoenas and to produce all records in his possession or control that might properly be demanded, and to testify if called as a witness. There was no necessity for him to add that stringent civil and criminal sanctions offer adequate protection to the stockholders against fraud in litigation. Petitioners ignore these deterrents in urging that unless some new rule is adopted, a director will be encouraged to conceal information in the course of litigation challenging a proposed settlement, and that "Once successful in maneuvering a settlement through a court, as here, the directors will be allowed, under the rules stated by Judge Moore, to keep the property taken from the stockholders. . . ." (Pet. Br. p. 29).

Petitioners mistakenly assume that the director would be willing to risk (i) prosecution for perjury in the giving of false testimony with respect to material matter in the judicial settlement proceeding (see N. Y. Revised Penal L. art. 210); (2) prosecution for tampering with the evidence (See N. Y. Revised Penal L., Art. 215.40); (3) the court's setting aside of its own judgment because of fraud, mistake, or after-discovered evidence (see CPLR 5015); (4) assessment of costs; and (5) prosecution of the underlying stockholders' derivative action.

The New York courts undoubtedly handle as much corporate litigation as any judicial system in the United States. The legislature and the New York Judicial Conference have found existing sanctions to be adequate to insure that the administration of justice will not be thwarted by means of the fraudulent practices claimed to have been prevalent in *Zenn*.

**The New York Court which approved the *Zenn* settlement offers the more complete remedy and the more appropriate forum for petitioners' complaint.**

This Court has repeatedly affirmed dismissal of collateral attacks upon state court judgments where an adequate remedy is available in the court which rendered the judgment under attack.

> "The obvious inquiry arises at this stage of the case, why the plaintiff has not brought to the attention of the State Court the fraud alleged to have been practiced upon it . . . The State Court is still open to listen to the complaint of the corporation and its shareholders . . . The plaintiff, therefore, has an ample and complete remedy for all his alleged grievances in the State Court, and there is no occasion for his application to this court for relief by bill in equity." *Graham* v. *Boston H. & E. R.R.*, 118 U. S. 161, 177-78 (1886).

> "We think that for this court, after all this has been done, to undertake to decree that what that court did is void, to sit in review on its judgment, and reverse its decree and set aside its sale, in a case where its jurisdiction is undoubted, is unwarranted by the relations which subsist between the two courts. It would be an invasion of the powers belonging to that court, and such a

> doctrine would, upon the simple allegation of fraud practiced in the court, enable a party to retry in a Federal Court any case decided against him in a State Court." *Nougue* v. *Clapp,* 101 U. S. 551, 553-54 (1879).

*Accord, Simmons* v. *Saul,* 138 U. S. 439, 458-60 (1891); *Broderick's Will,* 21 Wall. 503, 509-10, 512 (1874).

In his discussion of collateral attacks in federal courts on state court judgments, Professor Moore reaches the same conclusion:

> "What effect does the adequacy of the state remedy have upon federal equity jurisdiction? If an adequate state remedy is available and the aggrieved party invokes that and pursues it to final judgment, this judgment is entitled to be given the usual res judicata effect . . . [P]rior to *Erie* it was generally stated that the aggrieved party could invoke the federal remedy, by an original action brought in the federal court, without first pursuing the remedy provided by state procedure. Insofar as this doctrine permits resort to the federal courts in situations where an independent action would lie in the state court . . . it is sound; but we believe it should be reevaluated insofar as it permits the federal court to disregard the adequacy of the state remedy for relief by motion or other supplementary proceedings in the state court which rendered the judgment. If the supplementary state remedy is not a plain, adequate and complete remedy, then resort to the independent action in the federal court seems eminently proper. If, on the other hand, the state supplementary remedy is plain, adequate and complete, we believe . . . that an appropriate regard for state judicial administration should normally cause the federal court, in the exercise of a sound discretion, to refuse to exercise its equitable powers." 7 Moore, Federal Practice 631-32 (2d ed. 1955).

**The adequacy of petitioners' remedy in New York requires the dismissal of the writ of certiorari.**

These reasons require rejection of the rule which petitioners now propose for the purpose of setting aside the judgment of the New York Supreme Court. Whether petitioners' claim be viewed as one of deliberate and intentional concealment of evidence from the *Zenn* court or failure to search out and volunteer such evidence, the present petition should be dismissed for the reason that the New York court which approved the *Zenn* settlement possesses the power to give more complete relief and, with all parties to *Zenn* before it (Ex. I-42, R. 2283), is the more appropriate forum. *Cf. Pennsylvania* v. *Williams*, 294 U. S. 176, 182, 183 (1935).

The courts of New York have always had the inherent power to set aside or modify their own judgments for fraud, mistake, or similar irregularity, in the interest of justice.

> "The power of the court to control its judgments and to set aside a judgment for fraud or deceit practiced by a party is undoubted, and is not subject to the limitation of time prescribed in sections 724, 1282 and 1290 of the Code of Civil Procedure. Cases of fraud are not within these sections." *Furman* v. *Furman*, 153 N. Y. 309, 314 (1897).*

* *Accord*, Hogan *v.* Supreme Court, 295 N. Y. 92, 96 (1946); Ladd *v.* Stevenson, 112 N. Y. 325, 332 (1889); Hatch *v.* Central Nat'l Bank, 78 N. Y. 487 (1879); Flanson Realty Corp. *v.* Workers' Unity House, 229 App. Div. 179, 241 N. Y. Supp. 335 (1st Dep't 1930); In re Board of Directors of Automatic Chain Co., 134 App. Div. 863, 119 N. Y. Supp. 379 (4th Dep't 1909), *aff'd*, 198 N. Y. 618 (1910); Tomczak *v.* Roetzer, 283 App. Div. 851, 128 N.Y.S. 2d 911 (4th Dep't 1954); In re Bancroft, 195 Misc. 208, 83 N.Y.S. 2d 804, 806 (Chautauqua Co. Ct. 1949) *app. dismissed*, 96 N.Y.S. 2d 109 (4th Dep't 1950); Klein *v.* Fairberg, 243 App. Div. 609, 276 N. Y. Supp. 347 (2d Dep't 1935); Bonnelle *v.* Follo, 84 N.Y.S. 2d 466 (Supp. Ct. Kings Co. 1948), *modified*, 90 N.Y.S. 2d 244 (2d Dep't 1949).

This inherent power of the New York courts to set aside their own judgments on motion has now been codified in C.P.L.R. 5015(a).* See *McCarthy* v. *Port of N. Y. Authority,* 21 App. Div. 2d 125, 248 N.Y.S. 2d 713 (1st Dep't 1965).

Unlike collateral attack in another court, the grounds for a motion in the New York Supreme Court to set aside its own judgment are not limited to extrinsic fraud, "Legislative Studies & Reports", 7B McKinney C.P.L.R. 3401-5100, pp. 581-82), nor is there any statute of limitations preventing petitioners from turning to such procedure in the instant case. See *Furman* v. *Furman, supra.* Petitioners would also have the right to take depositions in support of such a motion. See *Matter of Estate of Sakel,* 9 App. Div. 2d 763, 193 N.Y.S. 2d 163, 165, *appeal dismissed conditionally,* 193 N.Y.S. 2d 623 (1st Dep't 1959); *Loonsk Bros.* v. *Mednick,* 246 App. Div. 464, 285 N. Y. Supp. 801 (4th Dep't 1935); *Etter* v. *Early Foundry Co.,* 164 Misc. 88, 298 N. Y. Supp. 208 (Sup. Ct., Chemung Co. 1937).

Thus the New York law parallels Rule 60(b) of the Federal Rules of Civil Procedure, which empowers a federal district court to set aside its own judgment for "(3) fraud (whether heretofore denominated intrinsic or extrinsic), misrepresentation or other misconduct of an adverse party".**

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* Reproduced in Appendix A, p. 4.

** Similar rules empowering courts liberally to grant relief from their own judgments for intrinsic as well as extrinsic fraud, as well as an additional grounds, abound in other states as well. See, *e.g.*, 16 Ariz. Rev. Stats., R. Civ. P. 60(c) (Supp. 1965); Calif. Code Civ. Proc. §657; 1 Colo. Rev. Stats., R. Civ. P. 60(b) (1953); Del. Code Ann., Ch. Ct. Rule 60(b) and Super Ct. Rule 60(b) (1953); Ida. Stats. Ann., R. Civ. P. 60(b); Ky. Rev. Stats., R. Civ. P. 60.02; Mich. Code Ann., Gen. Ct. Rule 528.3 (1963); Minn. Stats. Ann., R. Civ. P. 60.02; N.M. Stats. 21-1-1 (60)(b) (1953); 9 Utah Code Ann., R. Civ. P. 60(b) (1953).

On the other hand, New York law sharply circumscribes the limits within which the judgments of its courts may be independently attacked by collateral attack in a new court unfamiliar with the prior proceedings. New York limits the grounds for such attack to the ground of extrinsic fraud, while pointing out to litigants the more salutory means of an application in the rendering court to set aside its own judgment. As the New York Court of Appeals noted in the landmark New York case limiting collateral attack to extrinsic fraud:

> "It does not follow that a defeated litigant is without redress for perjury. He can apply in the original action and in a proper case obtain relief." *Crouse* v. *McVickar*, 207 N. Y. 213, 219, 100 N.E. 697, 698 (1912).

Similarly, the "Legislative Studies & Reports" to C.P.L.R. 5015(a), 7B McKinney, C.P.L.R. 3401-5100, pp. 581-82, points out:

> "The 'fraud' specified in subparagraph 3 may be either extrinsic or intrinsic. . . . The court inherent power to relieve a party from the operation of a judgment in the interest of substantial justice is not limited in any way by the CPLR. . . .
>
> • • •
>
> "Relief is seldom sought by mens of an independent action since it may only be granted as to extrinsic fraud and not as to intrinsic fraud (see, e.g., Crouse *v.* McVickar, 207 N. Y. 213, 100 N.E. 697 (1912); while relief based upon either type of fraud may be obtained by means of a motion in the original action."

Under the practice in New York, a motion to set aside the *Zenn* judgment would be referred to the judge who passed upon and approved the *Zenn* settlement after consideration and review of the voluminous evidence taken on

the question of the settlement's fairness. See C.P.L.R. 2221. The *Zenn* judge (Hon. Owen McGivern) continues to function in the New York Supreme Court, as does the Referee (Hon. Robert J. Fitzsimmons). This Judge and Referee, who passed upon the fairness of the original settlement, would be in a better position than the federal court, which never passed upon it, to evaluate the significance of the documents allegedly withheld.

If the New York Judge were to conclude that the *Zenn* judgment rendered by him should be set aside or modified, he would be able, having continuing jurisdiction over all the parties to the settlement and judgment (Ex. I-42, R. 2283), to apply equitable principles and take such action as would be just under the circumstances rather than to hold Mr. Kirby for the claimed wrongdoing of Young and Purcell while permitting them, along with the Murchisons (who initiated this action), to retain the benefits of the *Zenn* judgments for themselves. (In this connection, see generally *Boese* v. *King*, 108 U. S. 379, 385-86 (1883). See also *Taxin* v. *Food Fair Stores, Inc.*, 287 F. 2d 448 (3d Cir.), *cert. denied*, 366 U. S. 930 (1961).)

## POINT VI

### Without Further Legislation, Section 14(a) of the Securities Exchange Act Does Not Measure (a) Kirby's Burden of Proffering Evidence in *Zenn* or (b) the Standard of Fraud for Determining Whether the *Zenn* Judgment Can Be Collaterally Attacked.

Despite the petitioners' reiteration of "fraud," "deceit," "concealment," "conspiracy" and the like in their brief, the essence of their case is the fact that in the course of a new search of the files of Kirby, of Alleghany, and par-

ticularly of IDS, they have now found a dozen documents which were not introduced in evidence in *Zenn*.

*Petitioners' entire case is that Kirby should have found these documents and offered them in evidence, even though adverse counsel, to whom they were made available, did not do so* (R. 649). The District judge (R. 2318, 2325), and at least two of the Court of Appeals judges who wrote opinions below, were agreed that there is no such duty known to the law in a contested proceeding, despite the undoubted and unchallenged weight of a defendant's continuing fiduciary relationship toward his adversaries with respect to corporate business in which he is not sued as an adversary.* (R. 2351, 2340, 2347-48)

To support this claim, petitioners now come forward with a new argument, which is stated as Question No. 1 in their Petition.**

Section 14(a) of the Securities Exchange Act deals only with the solicitation of stockholders' votes and like activities. Petitioners would have this Court read § 14(a) for two new purposes:

> (1) to define the obligations of Kirby, as a defendant in *Zenn*, to seek out and volunteer evidence in that action, between 1954 and 1960;

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* Pet. Br. pp. 2, 20-21, 22, 24, 33, distorts our position, and that of the judges below, particularly Judge Moore, as a claim that fiduciary duties are suspended during litigation. We discuss the fair accommodation of fiduciary duties and the director's right to defend himself in accordance with due processes of law at p. 194 *et seq.*

** "1. Where federal statutes (Section 14(a) of the Securities Exchange Act of 1934 and Rule X-14A-9) impose upon corporate directors standards of disclosure deemed necessary for the protection of the interest of minority shareholders, must a federal district court apply a comparable federal standard of disclosure in determining whether derivative actions alleging violation of these statutes have been fraudulently settled?"
This is no more than an alternative formulation of Question 5 of the Questions Presented in their Petition for Certiorari, p. 4.

(2) to fix the criterion the District Court should have used in determining what constituted fraud permitting collateral attack against the state court judgment in *Zenn*.

The New York courts and the New York legislature have, however, repeatedly examined the uses and abuses of stockholders' suits, both by fraudulent corporate officers and by plaintiffs, and have built up a far reaching system for their regulation,* which is generally regarded as effectively imposing high standards through special procedures, including that of § 626(d) of the Business Corporation Law,** codifying the rule applied in *Zenn* and like cases.*** Since petitioners do not explain how the standards they porpose would differ from those of existing New York law, they show no need for establishing such a rule in this case.

Similarly, the New York law permitting judgments to be re-examined, both directly and collaterally, constitutes a well-articulated plan of procedure, tested over the years in many situations.****

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* Meinhard *v.* Salmon, 249 N. Y. 458 (1928); Bosworth *v.* Allen, 168 N.Y. 157, 165-167 (1901); Wohl *v.* Miller, 5 App. Div. 2d 126, 169 N.Y.S. 2d 233 (1st Dep't 1957); Gerdes *v.* Reynolds, 30 N.Y.S. 2d 755, 773 (S. Ct. N. Y. Co., 1941).

** Reproduced in Appendix A.

*** See, *e.g.*, the New York courts' supervision and approval of settlements of stockholders' derivative suits in the following cases: Bookbinder *v.* Chase Nat'l Bank, N.Y.L.J., June 23, 1937 p. 3166, col. 7 ($2,500,000); Kalmanash *v.* Smith, N.Y.L.J., May 13, 1944, p. 1869, col. 6 ($1,000,000); Posen *v.* Cowdin, N.Y.L.J., June 3, 1943, p. 2164, col. 6 ($2,000,000); Corash *v.* Texas Corp., N.Y.L.J., Mar 2, 1943, p. 830, col. 6 ($7,000,000).

**** See CPLR 5015(d), which codified the preexisting New York law permitting courts to reopen their own judgments. Third Report of the Advisory Committee, 1959 Leg. Doc. No. 17, p. 204 (1959); 7 Carmody-Wait, New York Practice 375-76, 380, See Point V, pp. 149-51, *supra*.

Nonetheless, petitioners contend here that the New York courts' failure to apply § 14(a) of the Securities Exchange Act as the standard measuring Kirby's burden in *Zenn* was not error, but "fraud" warranting collateral attack.

Two fixed policies of judicial administration require that petitioners' argument be summarily dismissed. The first is that, as a court of appeal, this Court decides only questions considered or passed upon below. The second is the policy that finality be accorded to judicial decisions, including those passing on jurisdiction of the subject matter. In this case, the bearing of the Securities Exchange Act was adjudicated in *Zenn*, and no appeal to this Court was taken.

**A. The question was not raised or passed upon below and should not be considered.**

The petitioners' first Question Presented was never raised in the courts below. In *McCullough* v. *Kammerer Corp.*, 323 U. S. 327 (1945), this Court dismissed a writ of certiorari when it found that "[T]he only question for which we granted certiorari is one not properly raised, litigated or passed upon below." And the Court said, in *United States* v. *New York Telephone Co.*, 326 U. S. 638 (1946), "[T]hat point, whatever its merits, was not made until the case reached this Court. Accordingly, we do not consider it." (At n. 18, p. 651). This Court will review a question not raised or passed upon in the court below only in exceptional cases. *Lawn* v. *United States*, 355 U. S. 339, 362 n. 16 (1958); *American Surety Co.* v. *Baldwin*, 287 U. S. 156, 163-64 (1932).

The reason for the rule is that "[T]his Court sits as a court of review." *Duignan* v. *United States*, 274 U. S. 195, 200 (1927). The policy embodied in these cases is essen-

tial both to protect the Court's constitutional integrity, and to assure litigants a fair chance to meet and answer arguments which may determine their civil or criminal responsibility.

Petitioners do not justify the drastic breach in judicial method they propose here. They could have asserted their new theory based on § 14(a) below. And counsel in *Zenn* might have pursued their remedies on review from the state court.* Such procedures would guarantee uniformity in the construction and application of federal statutes, without violence to the due processes of law.

Petitioners have asserted their theory here in an attempt to evade, rather than appeal from, the per curiam decision below on the *Zenn* court's subject matter jurisdiction (R. 2375-6). Strong considerations of comity and order in the judicial process suggest that their argument, with its literally revolutionary implications for the allocation of authority between the nation and the states, not be considered without benefit of the traditional dialogue of briefs and opinions.

**B. The bearing of Section 14(a) of the Securities Exchange Act was considered in *Zenn*. No appeal from that judgment was pursued here. The *Zenn* adjudication precludes consideration of the issue now.**

In its opinion en banc, the Court of Appeals held unanimously that the issue of the jurisdiction of the New York Supreme Court, in the light of § 27 of the Securities Exchange Act, had been ruled upon by the New York courts, no attempt being made to secure review by this

* An appeal from the Zenn final judgment of June 21, 1960 approving the settlement was pending in the New York Supreme Court, Appellate Div. 1st Dep't, at the time when the Murchisons began this action. See 11 App. Div. 2d 938, 210 N.Y.S. 2d 748 (1st Dep't. 1960).

Court (R. 2376). The *Zenn* court had overruled objections to its jurisdiction based on § 27, finding specifically that the cause of action of Count I was one of common law fraud, the § 14(a) element in the complaint being incidental.*

This Court has recently reviewed the finality of decisions on jurisdiction in *Durfee* v. *Duke*, 375 U. S. 106 (1963). That case confirms the soundness of the Court of Appeals' decision that the petitioners cannot treat the *Zenn* proceeding as void by reason of the "exclusive jurisdiction" provision of § 27 of the Securities Exchange Act.

Petitioners refer to *J. I. Case Co.* v. *Borak*, 377 U. S. 426 (1964), in support of their argument. But *Borak* was the obverse of *Zenn*. There a stockholders' suit was brought in a *federal* court to enjoin a corporate merger, with jurisdiction resting on diversity of citizenship. The stockholder-plaintiffs claimed that the directors and officers of the corporation had violated § 14 of the Securities Exchange Act by making misrepresentations in the corporate statements soliciting proxies in favor of the merger. Review was confined by the court to alleged violations of the Exchange Act (at p. 429) which, the District Court held, raised only questions of federal law (at p. 430). This Court held that § 14(a) of the Act authorized the trial court fully to resolve the controversy, granting such relief as might be required to give effect to the purposes of the statute.**

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* We do not here repeat the review of the New York proceedings on this point contained in our Statement in opposition to Phillips' motion for Leave to File a Brief Amicus Curiae, filed February 16, 1966, at pp. 7-18.

** See, for a discussion of the state of the law before Borak, 2 Loss, Securities Regulation (2d Ed. 1961) 973-1036. For an anticipation of Borak, see Kauder *v.* United Board & Carton Corp., 199 F. Supp. 420, 421 (S.D.N.Y. 1961).

The Court did not mention or discuss the possible effect of §27 on the jurisdiction of *state* courts in stockholders' suits, where the causes of action, although raising primarily alleged violations of state law, also include an issue under §14(a)—negligible or substantial as the case might be. The decision in *Borak* does not determine the propriety of the New York court's exercise of jurisdiction in *Zenn*. *A fortiori*, it does not indicate any basis for allowing collateral attack on the New York judgment in *Zenn*.* *Borak* does not purport to qualify *Durfee* or *Angel* v. *Bullington*, 330 U. S. 183 (1947), and it does not do so.

Petitioners never explicitly claim that Section 14(a) preempts, by necessary implication, the established state law jurisdiction in the field of corporate law; nor, apparently, do they claim such preemption in stockholder suits arising solely under state laws. At page 46 of their brief, however, they invoke *Borak* as requiring a new federal rule to determine when federal courts should allow collateral attack for fraud on a state court judgment in stockholders' suits held by the state court to be based on issues of state law. We note the argument here because what it proposes is a way of avoiding the salutary rule of *Durfee*. Collateral attack on the ground that error in the New York

* See Chicot Co. Drainage District *v.* Baxter State Bank, 308 U. S. 371 (1940). Borak does not deal with the status of a state court judgment characterizing the case before it as rooted in state law, rather than the Securities Exchange Act. In Borak this Court was at pains carefully to distinguish Dann *v.* Studebaker, Packard Corp., 288 F. 2d 201 (6th Cir. 1961). There, this Court said, "[I]t was held that the 'preponderance of questions of state law which would have to be interpreted and applied in order to grant the relief sought . . . is so great that the federal question involved . . . is really negligible in comparison.'" 377 U. S. at 434. This finding was parallel to that made by the New York Supreme Court in Zenn.

court litigation is really "fraud" would be functionally equivalent to the procedure barred by *Durfee*. It amounts to a claim that the existence of the Securities Exchange Act made *Zenn* a nullity, to be ignored at will.

### C. Petitioners' theory cannot be drawn from the purpose, language or history of the Securties Exchange Act.

#### (1) The petitioners' attempt to apply Section 14(a) to the facts of this case.

The precise issue in the case is whether the District Court below should have ordered a collateral attack on the New York judgment in *Zenn*, entered on a stockholders' bill "cast in the mold" of state law (*Pan American Petroleum Corp.* v. *Superior Court*, 366 U. S. 656 (1961)) and found to rest mainly on issues of state corporation law.*

The judgment in *Zenn* was based on a finding that the settlement of the suit was "fair, reasonable and adequate," within the meaning of New York's case-law rules, which have since been codified as §626(d) of the Business Corporation Law. The ground advanced for the collateral attack in the federal court is "fraud" on the jurisdiction of the New York Court, in that Kirby did not offer 12 documents in evidence in *Zenn*.

There is no basis for a claim that these are problems of federal law. Whether the settlement of a stockholders' suit in a New York court is "fair, reasonable and adequate" within the intendment of New York law is surely a question of state law, even though one of the minor threads in the tangled skein of the *Zenn* case was the

* Ex. K-137, R. 1640-41. See p. 40, *supra*, and pp. 171-73, *infra*.

legality of a proxy solicitation under §14(a). There is no trace or hint of a federal question in the present complaint. Jurisdiction rests on diversity of citizenship.* Paragraph 64 of the Complaint alleges that Kirby's "separate settlement" in *Zenn* was a fraud, and should be "rescinded, vacated and declared void . . . by reason of the facts . . . alleged in paragraphs 1 through 62" (R. 187). No facts looking to federal law are mentioned in Paragraphs 1 through 62.

Paragraphs 38 and 39 do not rest on federal law. Paragraph 38 mentions two sources of the duty Kirby is claimed in Paragraph 39 to have violated by non-disclosure in *Zenn:* his "relationship to Alleghany as director, officer and controlling stockholder who had acquired Alleghany property in a transaction with Alleghany," and the claim that Kirby was a "proponent" of the settlement in *Zenn.***

**(2) The plan of the federal securities laws does not support petitioners.**

The fiduciary responsibilities of a director and officer of a corporation are defined in the first instance by the law of the state in which the company is incorporated. For corporations within the ambit of the Securities Act, the Securities Exchange Act, and other federal securities legislation, federal statutory obligations are superimposed upon those arising under state law. As a commentator has remarked, "[T]he federal securities laws affect a wide

* Paragraph 12 of the Complaint (R. 168) also refers to the Court's "inherent jurisdiction" as the basis for the claims against Respondent Ireland, discussed in his separate Brief.

**In fact, plaintiff stockholders were the "proponents" of the settlement in Zenn, and assumed the burden of satisfying the Court of its fairness to Alleghany. See p. 196, *infra*.

range of corporate activities, but generally they do not preempt complementary state laws; they are pervasive but not exclusive." Fleischer, *'Federal Corporation Law': An Assessment,* 78 Harv. L. Rev. 1146, 1153 (1965). Unless a matter is clearly meant to be covered exclusively by the federal statute, it is deemed to be subject to state law.

That this is the first principle in interpreting the reach of the federal securities legislation when Congress has not taken more positive preëmptive action is a manifest corollary of federalism, made explicit in this instance by §28 of the Securities Exchange Act.* A contrary result, as Professor Loss has remarked of a cognate problem, would have to rest on the assumption that Congress intended to change the basic system for regulating corporations, supplanting state law entirely or almost entirely. "[S]o revolutionary a federal intervention," Loss says, "would presumably have been more clearly expressed." 2 Loss at 903. An unlimited spread of the ideas of the securities statutes as a new and all-encompassing federal "general" or common law, Fleischer contends, "is not supported by discussions in the legislative

* Section 28 is reproduced in full in Appendix A. It provides "(a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; . . . Nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder."

The Labor Management Relations Act has no provision comparable to §28.

For a general discussion of the problem, see 1 Loss, Securities Regulation 102-105, (2nd Ed. 1961), discussing proposals for legislation to preempt the field, and substitute unitary national controls for the present system of concurrent state and national regulation.

history, nor is it necessary to achieve the Congressional purpose." 78 Harv. L. Rev. at 1160.

The cases and the legal literature fully document these propositions about the relationship of state and federal law in the areas dealt with by national securities regulation:

(1) The securities legislation is deemed to supersede state law only in the event of direct conflict, and then only to the extent of the conflict, as in *Rice* v. *Santa Fe Elevator Corp.*, 331 U. S. 218 (1947). The regulation of corporate affairs is an aspect of the commerce power on which Congress and the States have concurrent authority, within the meaning of *Cooley* v. *Board of Wardens*, 53 U. S. 299 (1851), at least until Congress chooses to occupy the whole or a much larger part of the field. Thus far, the scheme of federal regulation expressly contemplates the continued vitality of state blue-sky laws, state corporation laws, and state statutes and judicial proceedings to determine and enforce the responsibilities of corporate officers and directors. As this Court said, in discussing the function, history and development of the stockholders' suit as "the chief regulator of corporate management . . . the very nature of the stockholders' derivative action makes it one in the regulation of which the legislature of a state has wide powers. . . . We conclude that the state has plenary power over this type of litigation." *Cohen* v. *Beneficial Indus. Loan Corp.*, 337 U. S. 541, 549-550 (1949).

(2) In this field, unlike some parts of labor law and bankruptcy,* State and federal law are generally held to

* The problem under the Securities Exchange Act is not comparable in any way to that considered in Kalb *v.* Feuerstein, 308 U. S. 433 (1940), where the court carried out the express purposes of Congress in passing the Frazier-Lemke Act, 11 U.S.C. §203 (1946) for

co-exist, and to complement each other, accommodation being made when necessary in the interest of preserving as much of the State law as the purposes of the federal statutes permit.

(3) Although the principle governing the interpretation of the federal securities laws is to give them a broad construction, in the light of their remedial purposes, as this Court did recently in *Borak* and in *S.E.C.* v. *Capital Gains Bureau,* 375 U. S. 180 (1963), it was not Congress' purpose that the federal securities laws become in effect the federal incorporation laws Congress has often considered, but never adopted. It is even more apparent that Congress did not intend the result sought here—the supersession, so long as the corporation comes within reach of the Securities Exchange Act, not only of state corporation laws but of state jurisdiction over stockholders' bills and other suits to regulate the relations between corporate management and stockholders.

Petitioners' position assumes away §28 and all that lies behind it. It rests on a premise which is exactly opposite to the one Congress has adopted—that corporations within any part of the jurisdiction of the SEC for any purpose become completely subject to a new and uncodified federal common law of corporations.

Many cases under the national securities laws and state corporation statutes illustrate the way in which the courts seek by conciliatory interpretation to give effect to both. *J. I. Case Co.* v. *Borak,* 377 U. S. 426, 434 (1964). It is a policy inherent and inevitable in the nature of the constitutional relationships between the nation and the states,

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the relief of farmer debtors during the depression of the 'Thirties. There the Congressional purpose was to protect farmers completely against mortgage foreclosures once a farmer filed his petition under the Frazier-Lemke Act.

properly described as those of "cooperative federalism." "This pattern" Professor Mishkin writes, reflects deep values in our federal system—not that action of the central government represents an intrusion upon an otherwise perfect system of law, but rather that Congress legislates against a background of existing state law."* Federal statutes are almost invariably "incomplete and interstitial" in nature** and necessarily depend upon the support of state law at many points and in many ways, sometimes being supplemented and complemented by the general authority of state law and at other times incorporating state laws by reference. In carrying out the policies and purposes of federal legislation, even in fields of almost completely national interest, the courts frequently refer to state law, as this Court did in *DeSylva* v. *Ballentine,* 351 U. S. 570 (1956), arising under the Copyright Act. And the courts not infrequently establish the outer limits of federal statutes by reference to a more comprehensive body of state law, as was done in *Blau* v. *Lehman,* 368 U. S. 413 (1962), *Hanna Mining Co.* v. *District 2, Marine Engineers Beneficial Assn.,* — U. S. —, 86 S. Ct. 326 (1965), and *O'Neill* v. *Maytag,* 339 F. 2d 764 (2d Cir., 1964), where the court held that a complaint might state a cause of action under state law, but not under §10b of the Securities Exchange Act.†

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* Mishkin The Variousness of 'Federal Law,' 105 U. of Pa. L. Rev. 797, 811 (1957).

** Hart, The Relations between State and Federal Law, 54 Col. L. Rev. 489, 525 (1954).

† See also Errion *v.* Connell, 236 F. 2d 447, 454 (9th Cir. 1956); Regents *v.* Carroll, 388 U. S. 586 (1950) ("[W]e do not read the Communications Act to give authority to the Commission to determine the validity of contracts between licenses and others.") (p. 602); Cochran *v.* M. & T. Transp. Co., 112 F. 2d 241 (1st Cir., 1940) Bell *v.* Tug Strike, 332 F. 2d 330 (4th Cir 1964) (state law governs as to domestic relations in admiralty suit).

We have found no cases, and no suggestions in the literature, to support the petitioners' claim here that §14(a), dealing with proxy solicitation for corporate voting, should be interpreted to preëmpt and supplant state law in the two respects noted above, that is, as a standard of state law defining Kirby's burden as a defendant in *Zenn*, and as rule of federal procedure governing the availability of collateral attack for fraud.*

**(3) Neither the text nor the legislative history of Section 14(a) supports petitioners.**

Neither the text of §14(a) nor its legislative history supports either branch of the petitioners' argument. In terms, the section deals with the solicitation of "any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 12 of this title." As petitioners concede (Pet. Br. p. 28), the language of the Act neither sets forth nor implies a purpose to go beyond regulating the process whereby the stockholders of a defined class of corporations are solicited to vote for corporate action, through proxies or otherwise.

This court recently said in *J. I. Case Co.* v. *Borak*, 377 U. S. 426 (1964):

> "The purpose of §14(a) is to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation. The section

* Petitioners' position is not that of the dissent below, which rests only on the position that Kirby should be held responsible for the acts of Young and Purcell. See pp. 95-97, *supra*. Petitioners' attempt at p. 28 of their brief to interpret Judge Friendly's dissent as resting tacitly on their thesis. But the attempt is unconvincing. Judge Friendly's views on this point are made clear in his Cardozo lecture, p. 170, *infra*.

> stemmed from the congressional belief that '[f]air corporate sufferage is an important right that should attach to every equity security bought on a public exchange.' H. R. Rep. No. 1383, 73rd Cong., 2d Sess. 13. It was intended to 'control the conditions under which proxies may be solicited with a view to preventing the recurrence of abuses which . . . [had] frustrated the free exercise of the voting rights of stockholders.' *Id.*, at 14. 'Too often proxies are solicited without explanation to the stockholder of the real nature of questions for which authority to cast his vote is sought.' S. Rep. No. 792, 73rd Cong., 2d Sess. 12. . . ." 377 U. S. at 431-32.

Nothing in this statement suggests a Congressional purpose to do more than fix rules for corporate voting.* The regulation of corporate voting procedures does not subsume the rules of procedure in corporate litigation. Under the Federal Rules of Civil Procedure or the New York statutes, no stockholders' vote is required to approve settlements in derivative suits, as is the case under Chapter X of the Bankruptcy Act and other procedures dealing with reorganization or recapitalization. See, *e.g.*, 52 Stat. 890, 891, 11 U.S.C. §§ 572-573 (1938).

Nor does the legislative history of §14 support petitioners' position. When hearings were first held on S. 3420, the section was described by the administration's spokesman as follows:

> "This section relates to proxies. The purpose of the provisions is to require that when a management solicits stockholders for proxies, or when any

* The 1964 amendment of § 14(a), 78 Stat. 569, 15 U.S.C. § 78n, Subsection (c), is similarly concerned with the information to be given stockholders before they vote.

> committee solicits stockholders for proxies, the management or committee so soliciting proxies shall reveal the purpose of such solicitation of proxies. . . ." (Senate Hearings on Stock Exchange Practices, Senate Committee on Banking and Currency, 73d Cong., 2d Sess., p. 6543). See also Senate Report No. 792, 73d Cong., 2d Sess., p. 12; Senate Report No. 1455, 73d Cong., 2d Sess., p. 77.

In 1956, the Chairman of the SEC, J. Sinclair Armstrong, reaffirmed to the Senate Committee on Banking and Currency the limited applicability of the proxy rules:

> "The Federal power, therefore, relates to the solicitation of proxies by any person with reference to listed securities. * * * Whether proxies are to be solicited is a matter solely for the parties concerned. The federal power does not extend to compulsion or prohibition of solicitations. It comes into play only when solicitations occur." (Hearings Before the Senate Committee on Banking and Currency, S. 2057 and S. 879, "Stock Market Study," 84th Cong., 1st and 2nd Sess., Pts. 1-3, 1955-56, p. 1523).

The silence of Congress in the Securities Exchange Act is in contrast to its action on the subject of derivative stockholders' suits in the Investment Company Act of 1940, 54 Stat. 789, 15 USCA § 80a-1-52. Section 33 of that Act, 54 Stat. 839, 15 USCA § 80a-32, requires every registered investment company which is a party defendant to a derivative action to make a full report to the SEC of any court-approved compromise settlement or of any verdict or final judgment in any such action. Even this reporting requirement falls short of the bill originally proposed (S. 3580, 76th Cong., 3d Sess.). That bill would have given to the SEC power to review and render an

advisory report to the court on the fairness of a proposed compromise or settlement of a derivative action, and a federal court would have been deprived of power to approve a settlement or compromise until the Commission had filed its report.

The legislative history of the Securities Exchange Act does not contain any proposal to give the SEC a comparable role with respect to suits based on §14(a). Absent some intent to require special standards of supervision and disclosure with respect to such suits, it must be concluded that Congress has determined that the abundant protective procedural devices—both state and federal—which now exist are adequate to protect against wrongful conduct by officers or directors whose conduct is judicially challenged.

The SEC itself has not interpreted the power granted in §14(a) of the 1934 Act to cover any broader area than the actual solicitation of proxies or like authorizations of corporate action through stockholder votes. Rule 14a-2 of the SEC's proxy regulations states that "the rules contained in this regulation apply to every solicitation of a proxy. . . ." Recent pronouncements of the Commission have been even more explicit:

> "The application of Section 14(a) of the Securities Exchange Act and of the proxy rules is keyed to the concept of 'solicitation' of a proxy. If an activity constitutes solicitation, it is subject to the rules, otherwise not. Rule 14a-1 defines 'solicitation' to include 'the furnishing of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy.'" (Exchange Act Release 34-7208, Jan. 7, 1964.)

Neither the terms nor the silences of the Securities Exchange Act, nor its legislative or administrative history, support the petitioners' proposal to apply the Act beyond the field of stockholder voting.

**D. Petitioners' rule would require amendment of the present statutory scheme.**

The necessity of circumventing *Durfee* and its predecessors forces the petitioners, however, to place great emphasis on their double argument that collateral attack should be available (1) because the court in *Zenn* did not apply §14(a) as a standard of state procedural law in determining Kirby's burdens as a defendant in that proceeding;* and (2) because the court below failed to apply §14(a) as a rule of federal practice to determine when federal courts should allow collateral attack for fraud.**

In a nutshell, the petitioners pose the problem of defining a boundary between two powerful currents in the law: (1) the first is the development of "federal common law" in areas of special national interest, and around federal statutes and systems of statutory regulation; and (2) the other is the spreading influence of *Erie R.R. v. Tompkins*, 304 U. S. 64 (1938). The first tendency, represented by *Textile Workers Union* v. *Lincoln Mills*, 353 U. S. 448 (1957), and its progeny, tends to enlarge the autonomy of the federal courts. The pressure of *Erie* is in the con-

* "The duty of full disclosure prior to settlement of actions brought for violation of Section 14a must persist as a necessary supplement to the statute and the Commission's efforts to enforce it." (Pet. Br. p. 28)

**"For the same reason, where a judicially approved settlement of a §14a claim has been obtained without discharging that duty, the settlement cannot bar a further attempt to enforce the statute." (*Ibid.*)

trary direction, requiring the federal courts to follow state decisions where substantive rights of the parties are involved.

Where does petitioners' contention in the present case fit into the spectrum between *Lincoln Mills* and *Erie*?

The claim here goes far beyond the issue of *Lincoln Mills*, where the question was whether §301 of the Labor Management Relations Act authorized the federal courts to interpret and enforce the arbitration clause of a collective bargaining agreement. The enforcement of such clauses was found to be central to a basic purpose of the Act, the elimination of industrial strife through the promotion of collective bargaining "under law." §1, 61 Stat. 136, 29 U. S. C. §141 (1957); see also §2, 61 Stat. 136, 29 U. S. C. §151 (1947). The Labor Act prescribes a comprehensive code for the regulation of labor management relations. With respect to labor practices and problems dealt with by the chief provisions of that statute, the realm of state law is sharply confined by the blanket assertion of national authority. *San Diego Building Trades Council* v. *Garmon*, 359 U. S. 236, 240, 244-246 (1959); *Hanna Mining Co.* v. *District 2, Marine Engineers Benevolent Ass'n.*,—U. S.—, 86 S. Ct. 327 (1965).

The fundamental scheme of the Securities Exchange Act is altogether different. It has no statutory base similar in scope to §301 of the Labor Management Relations Act of 1947, 61 Stat. 156, 29 U. S. C. §185. On the contrary, the Securities Exchange Act is a limited grant, circumscribed by §28.* Section 27 requires that criminal actions to enforce the Act, and similarly "suits in equity and actions at law brought to enforce" liabilities and duties created by the Act be brought in the federal courts. It does not, however, preempt state court jurisdiction over cases of state law where a question arising

* The text appears in the Appendix A, p. 1.

under the Act may also be involved. See *Pan American Petroleum Corp.* v. *Superior Court,* 366 U. S. 656, 662, 664 (1961).

Judge Friendly in his *Cardozo* lecture, "In Praise of Erie—and of the New Federal Common Law" (1964), concluded that an extension of the Securities Exchange Act such as petitioners seek here could be accomplished only by statute. *Lincoln Mills,* Judge Friendly said, stands for

> "[T]he doctrine that by granting the federal court jurisdiction over suits 'for violation of contracts between an employer and a labor organization representing employees in an industry affecting commerce . . . or between any such labor organization,' Congress gave a mandate to federal judges to fashion a body of contract law consistent with the policy of federal labor statutes and binding in all courts. . . . If the grant of federal jurisdiction in suits on labor contracts affecting commerce was a mandate to fashion a federal common law consistent with federal labor legislation, presumably a similar grant of jurisdiction in suits by stockholders of corporations whose securities are traded in commerce, adorned with a bit of legislative history, would empower the federal courts to fashion a *corpus* of law on the responsibility of officers and directors consistent with federal securities legislation; and this, like the federal common law of labor, would have supremacy over state law."*

The larger questions of policy posed by the Petition should be answered in the negative at this stage. The

* Vol. 19, No. 2, Record of the Association of the Bar of the City of New York, 1964, pp. 85-86. Judge Friendly also notes that a statute along these lines could make state security-for-cost statutes inapplicable in federal court actions, and impose what he regards as more effective standards with respect to the settlement of stockholders' suits—possibly with advisory participation by the SEC.

proposals made here by the petitioners are so far-reaching and obscure; they raise so many doubts and difficulties both constitutional and statutory; and they would have such unpredictable consequences on the federal system, that they should be held, as Judge Friendly concludes in his lecture, to require legislative sanction before being considered by the courts. *United States* v. *Standard Oil Co.*, 332 U. S. 301 (1947); *Bernhardt* v. *Polygraphic Co.*, 350 U. S. 198 (1955); *United Steel Workers of America* v. *Bouligny*, 34 U. S. L. Wk. 4019 (Nov. 23, 1965).

**E. The arguments of Point I of petitioners' brief rest on a misconstruction of *Zenn*, and on inapposite cases.**

**(1) Petitioners' characterization of *Zenn*.**

Petitioners argue, however, that while a defendant's burden of proof *in litigation to enforce §14(a)* is not expressly covered by its text, the effective enforcement of the Act, in the light of its purposes, should be deemed to require a uniform federal rule, calling on the defendant to disclose in such litigation the facts he would have been required to disclose in a proxy statement prepared at the time of the transaction (Pet. Br. p. 30).*

The premise of petitioners' argument is the phrase underlined in the preceding paragraph: *"in litigation to enforce §14(a),"* The idea is a lietmotif of their brief, starting with its first sentence.**

The first difficulty with their premise is that the court in *Zenn* held that the first cause of action in *Zenn* was not "litigation to enforce §14(a)", but was a common law count based on conduct alleged to have violated the proxy

* The error of considering a pleading as if it were a proxy statement is dealt with at pp. 193 *et seq., infra.*

** See further, Pet. Br. pp. 2, 3, 6, 20, 21-24, 26, 28, 30-33, 44.

regulations.* No appeal was taken to this Court from that determination.

The complaint in *Zenn* dealt with a large number of charges of common law fraud, involving many complex transactions (Ex. 1, R. 705-28). The Referee ruled, right or wrongly, that

> "'[E]very essential element of appellant's case depends upon common law and the statutes of New York; and that 'appellant's claim is for violation of State created rights, in no real or substantial sense dependent upon the provisions of the Securities Exchange Act of 1934 relative to proxy statements,' so that 'the allegations with reference to the proxy statement constitute a mere excrescence or superfluity tacked on to what are otherwise sufficient allegations of a claim for relief under New York Law.'" [R. 1640-41.]**

This was the view of *Zenn* taken at the time by the draftsman of the *Zenn* complaint who represented the Alleghany stockholders including the petitioners. Thus William E. Haudek, Esq., a partner in the firm of Pomerantz, Levy and Haudek, general counsel for the *Zenn* plaintiffs, concluded that the reference to §14(a) in the complaint was merely duplicatory of the common law aspects of the case, and surplusage:

> "(2) The allegation of the complaint referring to § 14 of the Securities Exchange Act is but a legal conclusion. There is nothing in the complaint to suggest that the Securities Exchange Act was to be the basis, let alone the only basis, of the first

* Zenn *v.* Anzalone, 1 App. Div. 2nd 662, 146 N.Y.S. 2nd 286 (1955); 1 App. Div. 2nd 773, 149 N.Y.S. 2nd 213 (1956).

**The Referees' opinion was "adopted as the decision" of the Supreme Court (R. 1720), and affirmed on appeal. Zenn *v.* Anzalone, 10 App. Div. 2d 912 (1st Dep't 1960), 11 App. Div. 2d 938, 210 N. Y. Supp. 2d 748 (1st Dep't, 1960).

cause of action. The facts alleged in the first cause of action, including those relating to the false proxy statement, clearly state a claim arising under the common law; see In re Scheuer, 59 N. Y. Supp. 2d 500, 501 (S. Ct., N. Y. Co., 1942); Matter of R. Hoe & Co., 137 N. Y. Supp. 2d 142, 148 (S. Ct., Bronx Co., 1954). This Court has undoubted jurisdiction to pass upon this common law claim even if it be coterminous with a possible federal claim."*

**(2) Petitioners rely on cases involving *direct* appeals from decisions construing applicable federal law. None deal with the problem of this case.**

The cases on which petitioners rely, *Dice* v. *Akron C. & Y. R.R. Co.*, 342 U. S. 359 (1952), and *Garrett* v. *Moore-McCormack Co.*, 317 U. S. 239 (1942), unlike the present proceeding, were cases of direct review by this Court of state court adjudications under the Federal Employers Liability Act and the Jones Act, respectively. In those cases, plaintiffs' cause of action was *exclusively* based on federal substantive law, whereas the claims in *Zenn* were held to arise under state law, the allegations of violation of §14(a) being deemed incidental to the common law claim.

*Dice* and *Garrett* stand for the familiar rule that the substantive delineation of a cause of action is drawn throughout from the substantive governing law—federal law where the cause is federal, state law where it is rooted in the law of a state. In *Dice* and *Garrett,* the governing substantive law was federal, and all aspects of the cause of action presented only federal questions. They

* "Papers on Appeal from Order" in Zenn before the Appellate Division of the New York Supreme Court, 1st Department, October 26, 1955, Affidavit of Opposition to objecting stockholders' fourth attempt to prevent the court from passing on the propriety of the settlement, p. 44.

held that where state courts enforce causes of action *based entirely* on federal statutes, the state courts must apply federal rules as to burden of proof, which are considered to inhere in the cause of action. *Garrett, supra,* at p. 249.

If this proceeding were a direct review of *Zenn,* the Court would have to consider the bearing, if any, of cases like *Dice* and *Garrett,* in view of the New York court's characterization of the actions in *Zenn* as causes rooted in state, not in federal law. This case is not, however, a direct appeal from *Zenn,* but a collateral attack by a federal court on a state court judgment entered over six years ago.

We deal with the policy implications of the petitioners' proposed rule at p. 194 *et seq.* of this Brief. At this point, the full availability in cases like *Zenn* of direct appeal to this Court from the state courts, and of liberal state court remedies (such as N. Y. C.P.L.R. 5015(a)*) is a sufficient comment on their contention that the decision below defines a "loophole" in the protections afforded by the Exchange Act. (See p. 122, *supra.*)

**(3) Petitioners' reliance on cases dealing with classic and aggravated instances of what has come to be called "extrinsic fraud."**

In presenting their case below, petitioners' counsel did not argue, as he does here, that §14(a) of the Exchange Act required Kirby to put the 12 "concealed" documents in evidence in *Zenn.* Instead he urged that a director-defendant charged with fraud is under a duty, as a matter of state law, to seek out and disclose all information

* More liberal with respect to time than Rule 60(b) of the Federal Rules of Civil Procedure.

known to him or which should be known to him by reason of his corporate capacity. This theory was rejected by the District Court and unanimously by the Court of Appeals, the dissent in the Court of Appeals stating:

> "[A] director thus sued is not bound actively to ferret out information that will promote the case against him or show the improvidence of a settlement to which he has persuaded a stockholder's lawyer to agree. . . ." (R. 2351)

The cases on which petitioners rely (Pet. Br. pp. 31-32) do not concern the question posed by this record: whether Kirby was under this special burden of seeking out and volunteering the evidence in question as a director-defendant in a contested action like *Zenn*, even though adverse counsel either missed the documents or decided not to use them.* Petitioners' cases concern problems totally different from those presented by the facts here. *Fiske* v. *Buder*, 125 F. 2d 841 (8th Cir. 1942), *Ferguson* v. *Wachs*, 96 F. 2d 910 (7th Cir., 1938), and the others deal with classic plots to deceive and mislead courts—cases where lawyers and executors conspire to steal assets, conceal the existence of distant heirs, threaten witnesses with death or bodily harm, and so on. They are textbook instances of what is generally called extrinsic fraud. Of course under such circumstances the trustees are held for their failure to inform the Court, even on collateral attack, since the court which originally passed on the parties' rights was deprived of any opportunity to exercise its judicial function, and "there was in fact no adversary trial or decision of the issue in the case." *United States* v. *Throckmorton*, 98 U. S. 61, at 65 (1878).

* We defer to Point VII the bearing of these cases on the availability of collateral attack.

Despite petitioners' outcry of "fraud," the evidence at pp. 288, 399, 401, and 595-96 of the Record,* conclusively distinguishes the present case from those cited by petitioners.

In the only case found where a like proposition was presented, the Court of Appeals for the District of Columbia held that a charge that director-defendants in a derivative action had failed to adduce material facts bearing on the reasonableness of a settlement is not a ground for collaterally attacking a New York judgment approving settlement of a derivative suit against them. *Reiter* v. *Universal Marion Corp.*, 299 F. 2d 449 (D.C. Cir. 1962).

**F. Petitioners' position raises constitutional doubts which should not be considered in the absence of clear congressional intent.**

Petitioners would require an extension of the scope and coverage of the Securities Exchange Act—one that could by no means be confined to problems linked, however indirectly, to proxy solicitation—to impose standards for the conduct of director-defendants in stockholders' suits in the state courts, and to require the extraordinary sanction of collateral attack as an enforcement device.

To the extent that petitioners seek the application in this suit, based on diversity of citizenship, of a federal standard that would cause a different result than the applicable state rule, they place themselves squarely within the authority of *Bernhardt* v. *Polygraphic Co.*, 350 U. S. 198 (1956), a case for breach of an employment contract, made in New York but to be performed in Vermont, and removed to the District Court of Vermont because of diversity of citizenship. Defendant sought to stay the

* Discussed at pp. 111-25 *supra* of this Brief.

proceeding pending arbitration under the arbitration clause of the contract, invoking §3 of the United States Arbitration Act. Section 2 of the Act makes contracts for arbitration "valid, irrevocable and enforceable" in any maritime transaction or in transactions involving commerce. Section 3 has no such limitation in terms, but provides for stays when the courts are satisfied that the issue involved in the suits before them "is referable to arbitration . . . under an agreement in writing for such arbitration."

While §3 was not in terms limited to maritime transactions and transactions involving commerce, as §§1 and 2 were, the Court read §3 as if the proviso has been inserted. "If respondents' contention is correct," Justice Douglas wrote, "a constitutional question might be presented. *Erie R. Co.* v. *Tompkins, supra,* indicated that Congress does not have the constitutional authority to make the law that is applicable to controversies in diversity of citizenship cases." The Court then distinguished an earlier case, decided before *Erie,* and one where the court did not consider "whether arbitration touched on substantive rights, which *Erie* held was governed by local law, or was a mere form of procedure within the power of the federal courts or Congress to prescribe. Our view . . . is that §3, so read, would invade the local law field. We therefore read §3 narrowly to avoid that issue." 350 U. S. at 202.

Justice Frankfurter concurred in Justice Douglas' majority opinion on the point in these terms:

> "Since the United States Arbitration Act of 1935 does not obviously apply to diversity cases, in the light of its terms and the relevant interpretive materials, avoidance of the constitutional question is for me sufficiently compelling to lead to a construction of the Act as not applicable to diversity cases. Of course this implies no opinion on the

> constitutional question that would be presented were Congress specifically to make the Arbitration Act applicable in such cases. Furthermore, because the Act is not here applicable, I abstain from any consideration of the scope of its provisions in cases which are in federal courts on a jurisdictional basis other than diversity of citizenship." 350 U. S. at 208.

It need hardly be pointed out that the "invasion of the local law" proposed by petitioners here in the name of §14(a) is on a scale that would dwarf the interstitial adjustment considered in *Bernhardt,* and there refused. Neither petitioners nor any one else has made the case for the constitutional earthquake they propose here.

This is the teaching of *United Steelworkers of America* v. *R. H. Bouligny, Inc.,* ——— U. S. ———, 34 U.S.L. Week 4019 (1965). Plaintiff, a North Carolina corporation, had sued the Steelworkers' Union in a state court for defamation. The alleged defamation occurred in the course of the Steelworkers' campaign to unionize plaintiff's employees. The Union removed to the federal court. On interlocutory appeal, the case was remanded to the state courts, despite the strong national interest in the underlying subject matter, and the far-reaching grant of jurisdiction to the federal courts in §301 of the Labor Management Relations Act.

Reviewing the successive changes since 1789 in the status of corporations as "citizens" under the Judiciary Act for purposes of diversity jurisdiction, the court declined to treat unincorporated trade unions as if they were corporations in this context, although it recognized the importance of the problem to many of the policies and purposes of the national system of labor legislation. "We are of the view" the Court said, "that these arguments, however appealing, are addressed to the inap-

propriate forum, and that pleas for extension of the diversity jurisdiction to hitherto uncovered broad categories of litigants ought to be made to the Congress and not to the courts. . . ."

## POINT VII

**Since This Collateral Attack Is Not Governed by the Securities Exchange Act, *Erie R.R.* v. *Tompkins* Requires that New York Law Be Followed in Determining Whether the New York Judgment Should Be Set Aside for Fraud. The Attack Does Not Meet the Requirements of New York Law.**

In Point VI we showed that the petitioners' twin rules cannot be distilled from §14(a) of the Securities Exchange Act. In the light of *Erie R.R.* v. *Tompkins,* the corollary of that conclusion is clear: *because* the petitioners' proposed position cannot be established as one of federal "general" or common law in the shadow of §14(a), and does not otherwise fall within an area of federal authority, "state law must govern because there can be no other law." *Hanna* v. *Plumer,* 380 U. S. 460 (1965) at pp. 471-472.

### A. The rule to be applied should not be regarded as one of pleading, practice or "housekeeping," but as going to the delineation of rights, and therefore within the policy of *Erie R.R.* v. *Tompkins.*

There were a few eddies of doubt, in the early years of *Erie,* as to whether the criterion to be applied in determining the availability of collateral attack for fraud should be considered "procedural" for the purposes of *Erie.* See *e.g., Griffith* v. *Bank of New York,* 147 F. 2d 899 (2d Cir.

1945). Those doubts have now been laid to rest by the cases which extend from *Guaranty Trust Co.* v. *York,* 326 U. S. 99 (1945), to *Bernhardt* v. *Polygraphic Co.,* 350 U. S. 198 (1955), and *Hanna* v. *Plumer, supra.* At the present time, the answer to petitioners' second Question Presented is that the District Court here was correct in applying New York law, as a matter both of reason and authority.

The underlying policy of *Erie,* recognizing the constitutional division of legislative authority between the nation and the states, is one of seeking equality and therefore fairness among litigants. "The *Erie* rule is rooted in part in a realization that it would be unfair for the character or result of a litigation materially to differ because the suit had been brought in a federal court." *Hanna* v. *Plumer, supra* at p. 467. The court has recognized the multiplicity of the interests involved, and the difficulty of drawing lines. In *Guaranty Trust Co.* v. *York,* 326 U. S. 99, 109 (1945), this Court said:

> "[T]he question is not whether a statute of limitations is deemed a matter of 'procedure' in some sense. The question is . . . does it significantly affect the result of a litigation for a federal court to disregard a law of a state that would be controlling in an action upon the same claim by the same parties in a state court? . . . The outcome of the litigation in the federal court should be substantially the same, so far as legal rules determine the outcome of a litigation, as it would be if tried in a state court."

This test is not a mechanical one, but it does give full effect both to the constitutional authority of the states, in defining substantive rights within their competence, and to that of the nation, under Article III of the Con-

stitution, in exercising diversity jurisdiction through federal courts.

Thus, in *Guaranty Trust Co.* v. *York, supra,* a state statute of limitations was enforced in a diversity case as a way to assure uniformity in the measure of substantive rights ultimately referable to state law, although statutes of limitation are often held to be "procedural" for other purposes. On the other hand, an overriding federal policy may prove decisive, as was the case in *Byrd* v. *Blue Ridge Rural Electric Cooperative, Inc.,* 356 U. S. 525 (1958), where the Seventh Amendment, and not state law, was held to govern the division of function between judge and jury in a federal trial, at least in the absence of a clear state policy to the contrary. 356 U. S. at 536-540. Similarly, in *Hanna* v. *Plumer, supra,* the mode of serving process in a diversity case was referred to Rule 4(d)(1) of the Federal Rules of Civil Procedure, and not state law, because the Rule was a constitutional exercise of Congress' power to provide for the internal management, practice, or "housekeeping" of the federal court system. 356 U. S. at 473.

Authority is hardly needed for the proposition that the regulation of the internal affairs of corporations, and the making of corporation laws, have been and still are areas where state legislation and state decisional law are of primary importance as substantive law. *Bigelow* v. *Old Dominion Copper Mining & Smelting Co.,* 225 U. S. 111 (1912). *Cohen* v. *Beneficial Loan Corp.,* 337 U. S. 541 (1949), gave effect in a diversity case to state policy regulating the conduct of stockholders' litigation, there being no conflict with Federal Rule 23.*

What petitioners contend is that Kirby was under a special burden of enquiry and of coming forward in *Zenn,*

* See, *e.g., Upson* v. *Otis,* 155 F. 2d 606 (2nd Cir. 1946), typically applying Delaware law to measure directors' fiduciary obligations.

as a director of Alleghany and a defendant in that action. Under *Erie,* the federal courts in diversity cases follow state law as to burdens of proof on the ground that they help define the parties' substantive rights. *Palmer* v. *Hoffman,* 318 U. S. 109, 116-117 (1943); *Cities Service Oil Co.* v. *Dunlap,* 308 U. S. 208 (1939).*

These decisions correspond with those which deal with the question of setting aside state court judgments for fraud in diversity cases where, again, the issue is deemed to concern the delineation of the parties' substantive right to the protection of a judgment, and the state's policy as to the finality of the judgments of its own courts. The prevailing view since *Guaranty Trust Co.* v. *York, supra,* is that where, as in the present case, a federal court's jurisdiction rests on diversity of citizenship, it should set aside a state court judgment only on grounds which would justify collateral attack if the proceeding had been brought in a court of the state where the judgment was entered.** *Reiter* v. *Universal Marion Corp.,* 299 F. 2d 449, 453 (D.C. Cir. 1962); *O'Boyle* v. *Bevil,* 259 F. 2d 506, 511-12 (5th Cir. 1958); *Curb & Gutter District No. 37* v. *Parrish,* 110 F. 2d 902, 907-909 (8th Cir. 1940); *Caterpillar Tractor Co.* v. *International Harvester Co.,* 120 F. 2d 82,

* The Court has applied the same principle in the obverse situation, when a *state* court is enforcing a *federally* created cause of action. In *Garrett* v. *Moore-McCormack Co.,* 317 U. S. 239 (1942), the Pennsylvania courts were found to be in error, in a case entirely under the Jones Act, for applying a state rather than a federal burden of proof in determining the validity of a prior release:

> "The right of the petitioner to be free from the burden of proof imposed by the Pennsylvania local rule inhered in his cause of action" (p. 249), cf. American Railway Express Co. *v.* Levee, 362 U. S. 19 (1923); Davis *v.* Wechsler, 263 U. S. 22 (1923); Dice *v.* Akron C. & Y. R.R., 342 U. S. 359 (1952).

** See, for a cognate fact situation, Feldman *v.* Pennroad Corp., 155 F. 2d 773 (3rd Cir. 1946).

85-86 (3rd Cir. 1941) (rule applied where question arose between federal courts sitting in different states).*

These cases are no more than particular applications of the general rule exemplified by *Aldrich* v. *Aldrich,* 378 U. S. 540 (1964); *Johnson* v. *Muelberger,* 340 U. S. 581 (1951); *Sherrer* v. *Sherrer,* 334 U. S. 343 (1948); *Coe* v. *Coe,* 334 U. S. 378 (1948); and *Roche* v. *McDonald,* 275 U. S. 449 (1928), holding that collateral attack on the judgment of a court of another jurisdiction is allowed only if it would be permitted in the courts of that jurisdiction.

The doctrine with respect to collateral attack for fraud by a federal court on a state court judgment is stated in 7 Moore, Fed. Practice 633-34 (2d ed. 1955), as follows:

> "Where the attack is made on the basis of such grounds as fraud, accident, mistake, or newly discovered evidence . . . *Erie* demands that the federal court grant or withhold relief, in accordance with state law, so that we will not have the spectacle that if the independent action be brought in the state court one result follows while if it is brought in the federal court a different result is reached. . . ."
>
> "[A] federal court sitting in . . . [a] state, which allows relief only where the fraud is extrinsic, should not grant relief from a judgment of that state on the basis of intrinsic fraud, although it might believe it was entitled to do so under the general doctrine of *Marshall* v. *Holmes.* Certainly the policy of *Erie-Tompkins* demands this where the state court judgment was rendered in a case in-

* There are dicta in Griffith *v.* Bank of New York, 147 F. 2d 899 (2d Cir. 1945), cert. denied, 325 U. S. 874 (1945), looking in the other direction, but the court there was at pains to rest its decision on alternative grounds, and to find that the fact situation met the "extrinsic fraud" standard of New York law, 325 U. S. at 903.

> volving only non-federal matters; and, further, the policy is in accord with that underlying *res judicata* and full faith and credit."*

Petitioners at no point face the fact that the New York courts reached the considered decision that the gravamen of *Zenn* was state, and not federal in character (Ex. K-137, R. 1640-41; Ex. K-138, R. 1720).** The New York court has characterized *Zenn* as primarily a stockholders' suit turning on questions of state corporation law, and not an action rooted to a significant extent in the Securities Exchange Act (R. 1640-1641). The Referee's opinion was adopted by the Supreme Court of New York (R. 1719). This decision was upheld in the Appellate Division of the New York Supreme Court. No further review was sought. The *Zenn* decision on this contested and considered point is entitled to be treated as res judicata, and afforded full faith and credit. *American Surety Co.* v. *Baldwin,* 287 U. S. 156, 166 (1932); *Durfee*

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* This statement modifies the position Prof. Moore seemed to take a decade earlier in Moore and Rodgers, 55 Yale L. J. 623, 655 (1946). Prof. Moore does not comment on the problem that might arise when a state court judgment deals with causes of action including both state and federal elements. The question does not arise here, because the state court ruled that the subject matter of Zenn was a matter of state law, the federal element in the case being an "excrescence and a superfluity." (Ex. K-137, R. 1641.) In any case, however, the answer of principle is given in Pan-American Petroleum Corp. *v.* Superior Court, 366 U. S. 656, 665 (1961): "The route to review by this court is open to parties aggrieved by adverse state court decisions on federal questions." The federal interest in protecting federally created rights can be fulfilled in such situations by direct appeals (as was the case in Dice, Garrett, Levee, and Davis *v.* Wechsler, *supra*), without breaching the important values of finality, full faith and credit and comity.

** The background of these jurisdictional decisions is reviewed in our Statement in Opposition to Phillips' Motion for Leave to File a Brief Amicus Curiae, filed February 16, 1966, pp. 7-15. We do not repeat that showing here.

v. *Duke,* 375 U. S. 106 (1963); *Treinies* v. *Sunshine Mining Co.,* 308 U. S. 66 (1939). See further *Chicot Drainage District* v. *Baxter State Bank,* 308 U. S. 371 (1940). And the petitioners here, whose predecessors were parties to *Zenn,* and who were in any event members of the class bound by that clear-cut adjudication in a class action, should not be heard now to attack the decision collaterally. *Stella* v. *Kaiser,* 218 F. 2d 64 (2d Cir. 1954); *Feldman* v. *Pennroad Corporation,* 155 F. 2d 773 (3rd Cir. 1946), *cert. den.,* 329 U. S. 808 (1946). Petitioners fail to explain why the *Zenn* court's characterization of the action as one rooted in state law is not res judicata as to them (Pet. Br. p. 44).

Their closest approximation to an answer is the sweeping assertion that the fulfillment of Congressional policy in enacting the securities acts is more important than considerations of finality or comity (Pet. Br. p. 50).

There is more, however, to the policy represented by *Erie* on the one hand, and the imperative of full faith and credit, on the other, than petitioners' airy comment would suggest. *Erie* rests on the constitutional necessity that the federal courts respect the law-making authority of the states in their proper sphere. *Bernhardt* v. *Polygraphic Co.,* 350 U. S. 198 (1955). What is at stake here is the protection parties can claim under New York law from a New York judgment in a case the state court has decided is one of common law. The policy of New York as to the rights of parties to reopen that judgment, or to attack it collaterally, is as much a matter of the substantive rights of the litigants in *Zenn* as any other aspect of the state's authority to make valid laws in the premises. Where the state courts have jurisdiction, their decisions are entitled to the safeguard of full faith and credit, even when in error. Petitioners' case here is a

transparent attempt to appeal from the state court's ruling on this point by calling it "fraud." They seek to evade the Full Faith and Credit clause by dressing Question 5 of the Questions Presented in their Petition for Certiorari (p. 4) in the costume of *United States* v. *Throckmorton*, 98 U. S. 61 (1878).

None of the cases cited under Point II of petitioners' brief deals with the problem of collateral attack by a federal court on a state court judgment for fraud. The only case they cite dealing with a conflict between the state and federal courts is *Capital Service, Inc.* v. *National Labor Relations Board*, 347 U. S. 501 (1954). There this Court upheld a federal court injunction against a state court injunction which interfered with the exercise of NLRB jurisdiction in a labor dispute within the Board's *exclusive* authority under the National Labor Management Relations Act. In the instant case, however, Section 28 assures the continuity of appropriate state law and state court jurisdiction.

Petitioners cannot find support for their position in the brief passage in *Mercoid Corp.* v. *Mid-Continent Investment Co.*, 320 U. S. 661 (1944), which dealt hypothetically with a problem of res judicata *between two federal courts*. In *Mercoid*, this Court was dealing with exclusively federal problems under the patent laws and the Clayton Act, not with questions exclusively or primarily of state law, or even with mixed questions of state and federal substantive law arising in a stockholders' suit, a field this Court has recently held to be one of strong state interest. *Cohen* v. *Beneficial Loan Corp., supra. Mercoid* could not have raised the question in issue here. It held something quite different: that a patentee would not be heard to invoke equitable protection for his patent, however valid, while misusing it in violation of the antitrust laws.

Petitioners cite a decision on rehearing in *Stella* v. *Kaiser,* 221 F. 2d 115 (2d Cir.), *cert. denied* 350 U. S. 835 (1955), a case involving a collateral attack in one federal court on a judgment, and releases given pursuant thereto, *in* another federal court. That case, however, is against their position here, and supports the position of respondents. In its original opinion (218 F. 2d 64 (2d Cir. 1954)) the court noted that the Michigan federal District Court, which rendered the judgment under attack for fraud in the New York federal court, had found that *the gravamen of the cause of action was rooted in federal law.* Since the original action was exclusively or primarily under the Securities Exchange Act, the Court, upon rehearing, held that the effect to be given to a release with respect to the subject matter of that action, must be determined as a matter of federal law. In this proceeding, the same principle dictates that New York law govern precisely because *Zenn* was one where a state court characterized the gravamen of the case before it as one of state, not federal law. Kirby was a party to *Zenn* for the purpose of the judgment attacked, and entitled to the protection of its judgment.

The rule therefore, as stated by Prof. Moore, is that in diversity cases federal courts are bound under *Erie* to allow collateral attack on state court judgments only on grounds that would be available if the attack had been brought in the state courts. It is explained and applied in *Reiter* v. *Universal Marion Corp.,* 299 F. 2d 449 (D.C. Cir. 1962). That case, like this one, was a collateral attack in a federal court on a state court judgment approving a settlement in a stockholders' suit. The federal court held that the validity of a judgment of the New York Supreme Court approving a settlement of a derivative action was governed by New York law, stating:

> "The full faith and credit clause of the Constitution, and the relevant statute, 62 Stat. 947, 28

> U.S.C. §1738, require us to give the Esposito judgment exactly the same force and effect that it would have in New York. See, *e.g.* Fauntleroy *v.* Lum, 210 U. S. 230, 28 S. Ct. 641, 52 L. Ed. 1039 (1908) . . . Moreover, it is clear that under New York law a final judgment in a stockholders' derivative action, binding upon the corporation, has res judicata effect and bars further litigation on the underlying causes of action. See Stella *v.* Kaiser, 218 F. 2d 64 (2d Cir. 1954), *cert. denied,* 250 U. S. 835, 76 S. Ct. 71, 100, L. Ed. 745 (1955); Dana *v.* Morgan, 232 F. 85, 89-90 (2d Cir. 1916)." 299 F. 2d at 452.

**B. The policy of New York is to limit the availability of collateral attack. Under the applicable rules of New York law, and equally under the federal authorities before *Erie,* petitioners' case for collateral attack fails.**

The accepted view is that in New York collateral attack is allowed only for what is called "extrinsic" fraud, as distinguished from "intrinsic" fraud.

> "Intrinsic fraud is one which 'occurred during the course of the trial upon a subject on which both parties presented evidence'; it is intrinsic to the issues which were litigated in the action. It usually consists in perjury or the offering of forged evidence. Extrinsic fraud, on the other hand, is fraud of a kind which prevents a party from having his day in court on one or more of the issues." James, Civil Procedure 540 (1965).

It is often said that the two leading pre-*Erie* federal cases, *United States* v. *Throckmorton,* 98 U. S. 61 (1878), and *Marshall* v. *Holmes,* 141 U. S. 589 (1891), are in conflict. But, as Professor James remarks, "actual results under the conflicting rules are probably not as discordant

as the statement of the rules would suggest." *Marshall* v. *Holmes, supra* at 542. As this Court said in *Toledo Scale Co.* v. *Computing Scale Co.*, 261 U. S. 399 (1923), at 421:

> "We do not find ourselves obliged to enter upon a consideration of the sometimes nice distinctions made between intrinsic and extrinsic frauds in the application of the rule, because in any case to justify setting aside a decree for fraud whether extrinsic or intrinsic, it must appear that the fraud charged really prevented the party complaining from making a full and fair defense."

When applied to the facts of the present appeal, both the New York cases and the older, pre-1938 federal cases require the same result—a denial of collateral attack. As this Court pointed out in *Hazel-Atlas Glass Co.* v. *Hartford-Empire Co.*, 322 U. S. 238 (1944) (a case not of collateral attack, but of a federal court reopening its own judgment after nine years), a court of equity has power to grant relief from its own unconscionable judgments in extreme cases despite judicial "deference to the deep-rooted policy in favor of the repose of judgments." 322 U. S. at 244. But the basis for judicial action of this kind should be a conviction of fraud, not merely a suspicion that the original court may have committed error. *Hartford Empire*, the court said, was "not simply a case of a judgment obtained with the aid of a witness who, on the basis of after-discovered evidence, is believed possibly to have been guilty of perjury. Here . . . we find a deliberately planned and carefully executed scheme to defraud not only the Patent Office but the Circuit Court of Appeals." 322 U. S. at 245-46.

Petitioners' case here simply does not qualify by such a standard.

Under these circumstances, the policy behind the New York rule—and the pre-*Erie* federal rule as well—would not classify the present case as one of "extrinsic" fraud justifying collateral attack, but would remit petitioners for their remedy, if any, to the New York Court which tried *Zenn*. This position rests on considered policies of order in judicial administration, as well as on that of favoring the end of litigation and the finality of judgments.

New York's adherence to the requirement that there be proof of actual fraud extrinsic to the litigation as a condition of collateral attack has been firmly established and long followed. *Verplanck* v. *Van Bureh*, 76 N. Y. 247, 258 (1879); *Crouse* v. *McVickar*, 207 N. Y. 213, 218 (1912); *Fuhrmann* v. *Fanroth*, 254 N. Y. 479, 482-483 (1930); *Jacobowitz* v. *Herson*, 268 N. Y. 130, 133-134 (1935).*

Even if proved, is the alleged failure of someone, not Kirby but possibly his co-defendants, to volunteer 12 documents which might have been of value in the course of the *Zenn* proceedings—documents which the courts below found cumulative of evidence before the *Zenn* court a basis for voiding a New York judgment? Collateral attack is never justified on the ground of fraud because counsel at the earlier trial decided not to use certain evidence, or because of the neglect or oversight of counsel at the previous trial, or the production of new evidence counsel might well have discovered in the exercise of reasonable diligence. *American Surety Co.* v. *Baldwin*, 51 F. 2d 596, 598-599 (D. Ida, 1931), *aff'd*, 287 U. S. 156

* Anchor Wire Corp. *v.* Borst, 277 App. Div. 728, 729-30, 102 N.Y.S. 2d 871, 872-73 (1st Dep't 1951); Burbrooke Mfg. Co. *v.* St. George Textile Corp, 283 App. Div. 640, 129 N.Y.S. 2d 588 (1st Dep't 1954); Chenu *v.* Board of Trustees, 12 App. Div. 2d 422, 424, 212 N.Y.S. 818, 820 (1st Dep't 1961) *aff'd*, 11 N.Y.S. 2d 688, 225 N.Y.S. 2d 760, *cert. denied*, 370 U. S. 910 (1962); Sadler *v.* Trisan, 20 App. Div. 2d 857, 248 N.Y.S. 2d 163 (1st Dep't 1964).

(1932); *Grubb* v. *Public Utilities Commission*, 281 U. S. 470, 478-479 (1930).*

Petitioners rely on cases where concealment of facts in breach of fiduciary duty were found to have prevented the original court from rationally considering the problem before it. Most of their cases were probate proceedings which may or may not have been contested in the first instance. For example, *Ferguson* v. *Wachs*, 96 F. 2d 910 (7th Cir. 1938), decided before *Erie R.R.* v. *Tompkins*, upheld a typical finding of extrinsic fraud in obtaining a probate court decree (at 916-17). The trial court found a conspiracy to conceal the deceased's ownership of certain stock from the probate court. The concealment was aggravated by duress. A witness was kept from testifying by threats to her life. And in *Fiske* v. *Buder*, 125 F. 2d 841 (8th Cir. 1942), where a court modified its own decree, extrinsic fraud was found (at 845) in the wrongful behavior of counsel, which had denied the parties from having previously had an opportunity to litigate the matter in issue (at 849).**

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* Phillips Petroleum Co. *v.* Jenkins, 91 F. 2d 183, 186 (8th Cir., 1937); Fidelity Storage Co. *v.* Urice, 12 F. 2d 143, 144 (D.C. Cir., 1926); Toledo Computing Scale Co. *v.* Computing Scale Co., 281 Fed. 488, 499 (7th Cir. 1922), *aff'd*, 261 U. S. 399 (1923); West Side Irrigating Co. *v.* United States, 269 Fed. 759 (9th Cir. 1921).

** Earll *v.* Picken, 113 F. 2d 150 (D.C. Cir. 1940) (concealed misappropriation of assets in uncontested proceedings);

Erbe *v.* Lincoln Rochester Trust Co., 3 N. Y. 2d 321, 144 N.E. 2d 629 (1962), *reversing* 2 App. Div. 2d 242, 154 N.Y.S.2d 179 (4th Dep't, 1956), which *aff'd* 1 Misc. 2d 413, 145 N.Y.S.2d 788 (S. Ct. Monroe Co. 1955) ("prior judgment obtained pursuant to a pre-arranged plan and conspiracy, and through the use of various misrepresentations, concealments and other deceitful devices.") 3 N.Y.2d at 325;

Hewitt *v.* Hewitt, 17 F. (2d) 716 (9th Cir., 1927) (failure to disclose existence of distant heir);

Graver *v.* Faurot, 76 Fed. 257 (7th Cir. 1896) (no trial in previous proceedings);

No such fraud was shown here. Blocked by the policy of *Durfee* v. *Duke*, 375 U. S. 106 (1963), petitioners seek a collateral attack on the New York court's decision on jurisdiction (R. 1640-41) by calling it a fraud. That decision may or may not have been in error. But no case has been made for labelling it fraud.

**C. Where the construction of state law is in issue, this Court normally defers to the construction of the lower courts.**

It is this Court's practice, *Bernhardt* v. *Polygraphic Co.*, 350 U. S. 198, 204-05 (1956), to "give special weight" to the construction of state law reached by the federal district courts, which are in constant touch with the development of state law. (See also 350 U. S. at 209-12) That policy would indicate a routine affirmance here, since the District judge carefully reviewed the applicable New York law (R. 2346-47).

## POINT VIII

**Petitioners' Proposed Federal Rule is Unfair, Impractical and Would Obstruct Termination of Costly and Protracted Stockholder Litigation.**

Petitioners distort Judge Moore's opinion below when they claim that his reasoning rests on the proposition that a director's fiduciary duties stop at "the water's-edge" of litigation (Pet. Br. pp. 2, 20, 2[illegible] 24-25, 33). He took no such position. Nor do we. At the time he is sued, a director may still be holding office as a director and have duties as such. But whether or not this is so, he has the constitutional right to defend himself against charges of

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Pickens *v.* Merriam, 242 Fed. 363 (9th Cir. 1917), (prior uncontested probate accounting obtained by false information to heirs "no adversary trial or decision upon these issues").

fraud in a case like the present one, which was not an uncontested proceeding, like most accountings in the administration of estates, but a protracted and bitterly fought stockholders' suit, involving many teams of lawyers, a full hearing, and several appeals.

Petitioners' proposed federal rule must be examined against the background of the law as it now stands (state and federal). Under that law there can be no question about the duty of a director-defendant to be honest with the court and the parties in such litigation. If he testifies, if he purports to furnish all material documents within his possession or control, or if he makes representations to the court or to the parties with respect to the issue in litigation or with respect to settlement of the litigation, he is under a duty not to misrepresent or conceal any fact or document believed by him to be material.

Petitioners would now add a further federal duty to search out and volunteer all evidence that "might be" considered material by his adversaries or by any stockholder who later rakes through the straw in the hope of finding something new with the aid of hindsight. In petitioners' view, the appropriate penalty for failing to meet this burden is collateral attack. They would establish these twin rules on the theory that a director must conduct his defense as if it were the solicitation of a proxy instead of the conduct of a lawsuit. There is of course a great difference between these two acts.

In the solicitation of a proxy the director is acting as a fiduciary in charge of the corporate business involved, whatever it may be. In a corporate suit against him for breach of his fiduciary duties, however, the institution of the suit forces him to become an adversary with respect to the claims against him, even though he continues to be a fiduciary toward his adversaries with respect to all

other corporate business. By resorting to the court's processes, the corporation and its stockholders have served notice upon him that they no longer consider him a fiduciary as to the matter in controversy. They have substituted the processes of the court for the fiduciary relationship that had existed with respect to those matters. So far as the issues in the corporation's suit against the director are concerned, the interests of the corporation and its stockholders are represented by the plaintiffs and their counsel, who are now treating the director as an adversary (and not a fiduciary). In the absence of a showing that the suit is malicious or an abuse of process, the corporate management's role is one of strict neutrality. *Rogers* v. *Hill*, 34 F. Supp. 358, 369 (S.D.N.Y. 1940); *Otis & Co.* v. *Pennsylvania R. Co.*, 57 F. Supp. 680, 684 (E.D. Pa. 1944); *Breswick & Co.* v. *Briggs*, 135 F. Supp. 397, 403 (S.D.N.Y. 1955).

The task of defining a director's duty might be different in the situation Judge Friendly mentions, that of an uncontested settlement in stockholder litigation, where plaintiffs seek only a blessing from the court approving the settlement (R. 2367-68). No such problem arises in this case, however, where the fairness of settlement in *Zenn* was attacked by objecting stockholders on exactly the ground raised here: the concealment from the *Zenn* plaintiffs of favorable "inside information" about the prospects of IDS in 1949 and early 1950.

In cases like *Zenn*, at least, the conflict of interests resulting from his adversary position prevents the director from making decisions for the corporation and its stockholders as to the course of the litigation, or the documents it should proffer. The responsibility is now vested in the plaintiffs and their counsel. It is they who must decide on behalf of the corporation whether the suit should

be prosecuted or settled; and whether a settlement is in the corporation's best interest.* As an adversary the director presumably desires to settle his claimed personal liability to the corporation for as low a sum as possible. To force him to carry water on both shoulders would put him in an impossible dilemma.

The duty proposed by petitioners, which would have required Kirby to ferret out and volunteer in *Zenn* the few documents later culled by petitioners' counsel from the files, would be contrary to the basic concept of the adversary proceeding. It would put the defendant in the impossible position of being forced to decide what is material to the plaintiff's case. It would have the effect of denying finality to judgments in stockholders' derivative suits, since there would be no way ever of assuring that the most thorough search of corporate files would produce all the documents considered "crucial" or material by another team of lawyers. It would eliminate all incentive for the settlement of stockholders' suits, even after appeals to this Court, for no one could ever be

* In Zenn, for instance, the Referee stated at the outset of his hearings:

> "It was my plan, with respect to the order of taking proof —subject to agreement on the part of all counsel in this case—to first take the proof of those who favor the settlement, and then take the proof of those who are opposed to it."

Thereupon the firm of Pomerantz, Levy & Haudek, general counsel for plaintiffs, undertook to present the evidence showing the fairness and reasonableness of the settlement, introducing exhibits and calling witnesses who were cross-examined by objectants' counsel (Graubard), who stated:

> "Mr. Pomerantz has said that he is the engineer of this proceeding and, as such, he apparently takes pride in what he has wrought to date." (*Zenn, et al* v. *Anzalone, et al.*, Supreme Court of the State of New York, County of New York, Transcript of testimony before Hon. Robert J. Fitzsimmons, Sept. 19, 1955, pp. 21, 33.)

certain that even a disposition by this Court would have finality under the petitioners' rule, against a later showing that previous counsel had overlooked a clutch of corporate papers, or decided not to use them.

Under petitioners' proposed rule the defendant would be required, at his peril, to come forward with whatever evidence *he* deemed to be relevant. Under modern pleading, issues are seldom stated so sharply that a director-defendant and his counsel could, in attempting to comply with such a rule, safely decide the relevancy of each of the thousands of documents that would be available in company and personal files, in a typical case. In fact, the charges could be repeatedly revised, as they were in the present action. Though the *Murchison* complaint was filed in September 1960, it was not until late 1962, after Kirby's deposition had been taken and after he had been called upon to produce documents relative to the original charges concerning which he had been deposed, that the theory was advanced that Kirby had defrauded the *Zenn* court by withholding evidence material to the fairness of the settlement. The charges were changed again on appeal and before this Court.

The adversary system of conducting litigation is founded on the conviction that opposing parties, dealing at arms' length, will use the process of the court and the pre-trial conference to narrow the issues, withdrawing claims that appear to be unsupportable, and making such concessions with respect to proof as enable the parties to present a justiciable controversy. Yet the standard proposed by petitioners would discourage orderly pre-trial and trial procedures in stockholders' derivative suits. How could a defendant's counsel, under the proposed rule, safely enter into stipulations narrowing the issues or limiting the volume of certain kinds of proof that might be offered?

Petitioners' rule would transform the stockholder's suit. Under the proposed rule, plaintiff need only file a complaint charging fraud, and then sit back. He would have a right to expect a full submission of corporate records by the named directors and officers. He need not even pursue discovery under pre-trial rules.

Petitioners' suggestion that the federal courts should, in the name of §14(a), take over state court jurisdiction in stockholders' suits, poses a question that goes far beyond the facts revealed by the record in this litigation. It may be that there is need for fundamental reform of the stockholders' suit as a method for policing the internal affairs of corporations, and that the task of reform should be taken over by the federal government, and not left to the legislatures and courts of the leading commercial states. But this Court should not assume this to be in fact the case.

Basic questions, not found in this record, are presented by Judge Friendly's speculation that under existing procedures stockholders' claims may be settled for inadequate amounts because the percentage allowance to plaintiffs' counsel diminishes after the $1 million mark is reached (R. 2367) or because the proceeding ceases to be an adversary one after "the attorneys for the plaintiff stockholders link arms with their former adversaries to defend the joint handiwork" (R. 2368).* Neither of these phenomena appeared in the present case, which involved

* The dissent's suggestion that the English practice of government prosecution of derivative suits be adopted by New York might have provided an interesting field for speculation were it not for the fact, overlooked by Judge Friendly, that until September 1963 New York did provide precisely such authority for its Attorney General in Sections 60-61 of the General Corporation Law. Contrary to Judge Friendly's suggestion, however, this power was rarely invoked and, indeed, had "never been utilized since October 1, 1929." 2 Hornstein, Corporations §734, at 258, n. 33 (1959). Moreover, so impractical did the English practice turn out to be here that, in drawing up the new Business

bitter and protracted adversary proceedings after the proposed settlement was presented by some *Zenn* stockholders for approval, and objected to by others, with the result that the final payment was $3 million, and a return to Alleghany of the control of IDS, valued at over $5 million by the objectants' counsel (R. 2300). Judge Friendly may also have overlooked numerous settlements of stockholders' derivative suits for more than $1 million.*

In any event, if there is such a need for reform, how should it be achieved? Through Act of Congress following the careful investigation and study that is a part of the legislative process? Through an effort to prepare and secure adoption of uniform state law, following the expert and long study that accompanies these important efforts? Through a combination of both methods? Or through the judicial process by decision of this Court in a case of collateral attack?

We submit that even if the matter were properly before this Court, this record is wholly inadequate to furnish a basis for the evaluation of such a far-reaching rule.

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Corporation Law enacted in New York effective September 1963, the revisers entirely omitted the power to bring derivative actions theretofore vested in the attorney general. See N.Y.B.C.L. §§706, 716, 720, superseding N.Y.G.C.L. §§60-61.

* Cherner *v.* Transiton Electronic Corp., 221 F. Supp. 48, 55 (D. Mass., 1963) ($5,300,000); Rogers *v.* Hill, 34 F. Supp. 358 (S.D.N.Y. 1940) (Settlement valued at $6,200,000); Perrine *v.* Pennroad Corp., 28 Del. Ch. 342, 43 A. 2d 721 (1945), *aff'd*, 47 A. 2d 479 (Del. 1946), *cert. denied*, 329 U. S. 808 (1947) ($15,000,000); Bookbinder *v.* Chase National Bank, N.Y.L.J., June 23, 1937, p. 3166, col. 7 (Hammer, J., S. Ct. N. Y. Co.) ($2,500,000); Corash *v.* The Texas Corp., N.Y.L.J., March 2, 1943, p. 830, col. 6 (S. Ct. N. Y. Co.) (Issuance of stock for a total evaluated gain of $7,000,000); Posen *v.* Cowdin, N.Y.L.J., June 3, 1943, p. 2164, col. 6 (S. Ct. N. Y. Co.) (Issuance of stock for total gain valued at $2,000,000); Adams *v.* Rockefeller, S.D.N.Y., Index No. E-13-363, Opinion No. 138, Dec. 28, 1920 ($2,500,000) (See Colum. L. Rev. vol. 39 at 808 n. 155); Donovan *v.* Atlas Corp., N.Y.L.J., Feb. 9, 1937, p. 689, col. 7 (S. Ct. N. Y. Co. 1939) ($1,500,000).

## CONCLUSION

**For all of the foregoing reasons, we respectfully submit that the Writ of Certiorari issued herein be dismissed as improvidently granted or, in the alternative, that the decision of the Court of Appeals below be affirmed.**

Respectfully submitted,

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